

ADDRESS
BY
MARRINER S. ECCLES
CHAIRMAN OF THE BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM

STENOGRAPHIC TRANSCRIPT OF REMARKS
TO THE
BUSINESS AND PROFESSIONAL MEN'S GROUP
UNDER THE AUSPICES OF THE
UNIVERSITY OF CINCINNATI
MARCH 27, 1936

ADDRESS
BY
MARRINER S. ECCLES
CHAIRMAN OF THE BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM

STENOGRAPHIC TRANSCRIPT OF REMARKS
TO THE
BUSINESS AND PROFESSIONAL MEN'S GROUP
UNDER THE AUSPICES OF THE
UNIVERSITY OF CINCINNATI
MARCH 27, 1936

I come before you tonight with a good deal of timidity. I appreciate, however, the opportunity of meeting with such a representative group of business and professional men who show by their presence here that they are seriously interested in public questions.

My background and economic philosophy

My experience in public life is of rather short duration. My background, I am sure, was a good deal like that of many of you. Up until the depression, I had given little or no thought to public questions. I had spent twenty-two years in the business of making money, in conducting banking and business enterprises in the competitive field. I have known what it was to employ thousands of men and I have known what it was to operate successfully banking and business enterprises. With the coming of the depression, I was required to confront problems which were entirely new to me, and as the depth of the depression continued, the seriousness of these problems dawned upon me. When I was put in the position of cutting salaries and wages, and of discharging or laying off faithful and old-time employees, I recognized at the same time that there was need for the services of all the men that were laid off because there were millions of people who needed and wanted the goods and services that they were able to provide.

I am not necessarily an altruist. I think I am a realist. I think the system of capitalistic democracy is, of necessity, an individualistic system, where there must be competition and self-interest. But at the same time, I think it has been brought home to us that our activities and our interests are much more closely associated with public interest than we had ever thought they were.

Lloyd George in 1909

I was impressed the other day in re-reading a speech made by the Honorable David Lloyd George in 1909, known as his "Limehouse Speech." I will read a very small part of it:

"It is rather a shame for a rich country like ours--probably the richest in the world, if not the richest the world has ever seen--that it should allow those who have toiled all their days to end in penury and possibly starvation. It is rather hard that an old workman should have to find his way to the gates of the tomb, bleeding and footsore, through the brambles and thorns of poverty. We cut a new path for him--an easier one, a pleasanter one, through fields of waving corn. We are raising money to pay for the new road--aye, and to widen it so that two hundred thousand paupers shall be able to join in the march. There are many in the country blessed by Providence with great wealth, and if there are amongst them men who grudge out of their riches a fair distribution towards the less fortunate of their fellow-countrymen they are very shabby rich men."

The economic system in 1928 and 1929--what was wrong

We thought in 1928 and 1929 that we had entered upon a new era, that we had banished poverty. As we look back and see what has happened since,

it is only natural that we should try to analyze what was wrong with the system under which we operated and what, if anything, we can do about it. It is evident that there was not a shortage of anything at the time the depression struck. We were better equipped and better able to supply the needs and demands of the people of this country than we had ever been before in our history. Our productive facilities of all kinds and our manpower were recognized by everyone as being adequate to maintain a reasonably decent standard of living for the citizens of this country. The processes of production certainly did not break down. I think it has become evident to all of us that it was largely the system of distribution that broke down.

It was not a question of confidence, because confidence was at a high ebb. It was not a question of an unbalanced budget, and it was not a question of not being on the gold standard. We had everything that was considered to make for sound financial and sound business procedure. We had no inflation in the generally accepted sense. The index of prices generally was on a very stable basis.

It is true that we did have a speculative inflation. It is true that great sums of money were going into the stock market very largely through loans by others, surplus funds, excess cash holdings of individuals and corporations. The total amount of bank credit expansion was not impressive. There was no bank credit inflation of sufficient amount to cause or create the speculative inflation that developed in the stock market and real estate market.

Brookings report on income distribution

You have all heard about the Brookings report in connection with this subject. I want to read the condition that was pointed out in the report on page 37 of "Income and Economic Progress."

"The consumptive requirements or wants of the people were far from satisfied during the period of our highest economic achievement. The value of the total national production of goods and services in 1929, if divided equally among the entire population, would have given to each person approximately \$665. There were nearly 6 million families with incomes less than \$1,000; 12 million with incomes under \$1,500; over 16 million with incomes under \$2,000; and over 19 million, or 71 percent of the total, with incomes less than \$2,500. A family income of \$2,500, at 1929 prices, was a very moderate one, permitting few of the luxuries of life. Hence it was clear that the consumptive requirements, and especially the wants, of the masses of the people were far from satisfied."

Speaking of what appears to be at least one of the reasons for some of our difficulties, the same report goes on to say:

"As to income distribution and its results, we found ... the proceeds of the nation's productive efforts going in disproportionate and increasing measure to a small percentage of the population--in 1929 as much as 23 percent of the national income to 1 percent of the people. We found the unsatisfied wants--needs according to any good social standard--of the 92 percent of all families who are now below the level of \$5,000 annual income sufficient to absorb the product of all our unused capacity under present conditions of productivity and still demand much more from such unexplored

potentialities as might thereafter be opened up. We found the incomes of the rich going in large proportion to savings and these savings strongly augmented by others impounded at the source by corporations through the practice of accumulating corporate surplus. These savings, after providing for such increase of capital goods as could be profitably employed, we found spilling over into less fruitful or positively harmful uses, ranging from foreign loans (bad as well as good) to the artificial bidding up of prices of domestic properties, notably corporate securities.

"Thus, we began to discern the answer to our question whether the basic defect in our economic system, not discovered in the technical processes of production, is to be found in the way in which we conduct the distribution of income. The answer is affirmative: this is the place at which we do find basic maladjustment."

Berle and Means on the concentration of wealth and income

Looking a little farther, in the study made by Berle and Means, "The Modern Corporation and Private Property," they state that the concentration of income has been accompanied to quite an extent by the concentration of corporate wealth. They found that 200 big companies controlled 49.2 percent, or nearly one-half, of all nonbanking corporate wealth at the beginning of 1930, while the remaining half was owned by the more than 300,000 smaller companies. They go on to say that the actual extent to which the concentration of power has progressed is striking enough. More striking still, however, is the pace at which it is proceeding. In 1909, the assets of the 200 then largest nonbanking corporations amounted to only \$26,000,000,000. By 1919 they had reached \$43,700,000,000, an increase of 68 percent in ten

years. In the next ten years, from 1919 to 1929, they increased to \$81,100,000,000, or an increase of 85 percent. At this rate, it is estimated that in another fourteen years one-half of the national wealth would be under the control of just a relatively few big companies.

Now, corporate profits were made and saved, that is, were not passed along in dividends to the stockholders. They were not passed along in lower prices to the extent that that would have been possible, or in higher wages. I am speaking of the corporate structure generally; I realize that there are many notable exceptions. What I am saying, I am saying as a corporation man. I am trying to look impartially, if I can, at the problem and see what it is possible for us to do to create a greater degree of stability in a capitalistic democracy.

Treasury figures on distribution of corporate income

Speaking of the distribution of corporate income, I had some figures made up recently from the Treasury records of the total net corporate income from 1923 to 1933 inclusive. These figures cover income and dividends paid by the nonfinancial corporations reporting income. It does not include those reporting losses. These figures show a net income of \$71,123,000,000. Dividends paid amounted to \$45,433,000,000 and undistributed income to \$25,691,000,000, or approximately 36 percent undistributed. Taking the corporations not reporting a net income for the same period, they paid out in excess of earnings \$5,837,000,000. These figures include the depression years to the end of 1933.

Credit extension by corporations

It seems to me that here is a phenomenon that needs to be given some thought and consideration. We know that the amount of credit extended

by banks to corporations diminished since the organization of the Federal Reserve banks until at the time of the depression in 1929 less than 13 percent of the total assets of the member banks were considered liquid eligible paper, that is, agricultural and commercial paper. At the present time this is less than 8 percent.

The credit field was to a very large extent absorbed by corporations. They have extended terms all the way down to the retailer and to the consumer. It seems to me that the prosperity that we had in the late twenties was due in no small measure to the use of credit, not that extended by the banking system, but to credit which was extended by our corporate structure, not only the large corporations which I have mentioned but by a great many small corporations as well. Some of these surplus funds, particularly of the larger corporations, went into the call market and stimulated, as we know, great speculation.

The conditions leading to Government intervention

Now, for a century and a half in this country we have always had reason to believe that we could not over-save as a nation, that savings would go into new capital equipment. We had a shortage of capital through most of our history. We were a great frontier nation. We were a debtor nation until the time of the war. We had a rapidly increasing population. Our technical development was advancing slowly. There was a need for the population as a whole to consume a minimum over the standard of living, and to save and invest a maximum. We had high interest rates, except for short periods, over a good part of the last century and a half. It is true that we have had depressions during that period, some very serious ones, but from very different causes than the present one that we have been going through.

It now appears that, when surplus funds are saved or accumulated, whether by corporations or individuals, they go into the capital market and provide more facilities and produce more goods and provide more transportation than the people as a whole are able to buy; in other words, creating a situation where productive capacity gets out of balance with consumer buying-power, so that we have the paradoxical situation of an economy of abundance with millions of people out of work and idle factories and unused goods as the flow of money stops and slows up.

The volume of money times the velocity of turnover of that money measures our volume of business. In 1929 we had a volume of adjusted demand deposits eliminating the inter-bank balances of \$22,744,000,000 in all banks. That excludes time or savings deposits. At the present time, there is approximately the same volume of adjusted demand deposits as at the peak in 1929. But in 1929 these deposits were not in the hands of the people who needed better houses, better furniture, better and more food, clothing, and education, as I have indicated by reference to evidence from the Brookings report on the distribution of income. We kept up prosperity by installment credit of all kinds at high rates to the masses of our people until it seemed to me that the point of saturation had been reached in the credit structure--not in the bank credit structure, but in the corporate credit structure. We know what happened.

Even in 1929 it is generally admitted that we lacked at least 20 percent of utilizing our capacity to produce, based upon the existing productive facilities and available labor. We know what the depression did to the banking system. In the process of deflation, bank deposits were decreased

by about one-third as the result of credit contraction over which the individual banks had no control. This credit contraction brought about a similar reduction in the velocity or turnover of money, so that the national income dropped from more than \$80,000,000,000 down to a low point of less than \$40,000,000,000, in direct relationship to the volume and velocity of our money supply. And yet all during that period everything that is accepted as orthodox in order to give and maintain confidence was done. An effort was made to keep the budget in balance through rigid governmental economy, at least for a time. We fought to preserve the gold standard at all hazards as though it were a very sacred thing. There was little Government interference. There was little legislation of a disturbing nature. And yet confidence did not come back. Why should it come back? Why should people with money invest that money in new productive enterprises when everything they had was becoming less valuable every day?

The objectives and results of Government spending

The intervention by Government was an absolute necessity. Through Government spending we supplied buying-power that otherwise did not exist and thereby restored solvency. The money for Government spending was provided by the banks who purchased Government bonds, some in small amounts, at least for the first several years of the budgetary deficit. The bonds were also purchased by investors and insurance companies, but the bulk were purchased by banks. The credit which the banks were unwilling and unable to provide to private individuals and corporations, largely because there were no borrowers, they provided to the Government. This credit to the Government served to replace the deposits that were extinguished through

the credit contraction by the banks during the depression until today we have demand deposits back to where they were in 1929. That can be accounted for entirely by the gold imports which were largely a result of devaluation, a small amount of silver purchasing for which silver certificates were issued in payment, and Government bonds and bonds guaranteed by the Government purchased by the banks, less the amount of private credit contraction which continued at banks even after the low point of deposits had been reached. Had it not been for the credit which was extended to the Government and Government agencies and the gold imports, the volume of deposits would be less today than at the time of the banking holiday because the amount of outstanding credit by the banks outside of that extended to the Government is less than it was at that time.

This borrowing by the Government and the resultant spending is responsible for the business recovery that we have had. It is responsible for an increase in the Federal revenue of nearly \$2,000,000,000. It is responsible for an increase in national income from a low point, \$40,000,000,000, to the present income of about \$60,000,000,000. Considering the results accomplished by this spending, the amount spent is insignificant in contrast to the wealth that it has resulted in creating.

Spending and the Government debt

At the time of the banking holiday, the Federal debt was approximately \$21,000,000,000. There had been a deficit of nearly \$1,000,000,000 in 1931 and a deficit of \$3,153,000,000 in 1932. During the period of the twenties, we made four major reductions in the income tax rates, the theory being that the lower the income tax, the greater the prosperity and the surer we were that private capital would continue to take care of the unemployment problem.

The gross debt as of December 31, 1935, was approximately \$30,000,000,000, an increase of between \$9,000,000,000 and \$10,000,000,000 from the period of the banking holiday. However, from the total debt of \$30,000,000,000 must be deducted the United States interest in assets owned by the R.F.C. and other Government agencies estimated to be worth around \$4,000,000,000. The Treasury balance was \$2,200,000,000 exclusive of the stabilization fund, which is not in the money system. It is the gold profit held in the Treasury and has not been utilized. The net increase in the debt then, excluding the stabilization fund, for that period of time is less than \$6,000,000,000, or less than one month of the national income of 1928 or 1929. The total debt of \$30,000,000,000, large as it is, is not much more than four months of the normal national income. In this connection, I think it is worthwhile noting that the interest rate on Government debt has dropped from 3.41 percent in 1932 to an average of 2.55 percent in 1935, and that the total interest charge has increased from \$697,000,000 a year in 1932 to \$751,000,000 a year in 1935, or an increase of only 8 percent in the total interest paid while the increase in the total debt was 44 percent.

A debt comparison with England

You have heard the comparison made with the English situation. I mention it only because England is spoken of as a country well able to manage her affairs, and of all the capitalistic countries under democracy she, perhaps, is the best example we have. The central government debt of the United Kingdom is 158 percent of the national income of the United Kingdom in 1934, and it would take one and one-half years of her income to pay it. Our debt was 38 percent of our national income in 1934. The debt of all public bodies, city, State, county, was 194 percent of the 1934 national

income in Great Britain and our total public debt was 74 percent of our 1934 income. The interest we paid on the debt of all public bodies was 3 percent of the national income of 1934. Eight percent of the 1934 income of the United Kingdom would be necessary to pay the interest on her public debt.

Recovery in real estate

You are familiar with some of the figures showing the extent of recovery. As we have seen, I think, they are largely the result of the spending I have referred to and also of the credit that the Government has extended in stepping into the picture to relieve creditors as well as debtors. By the way, the great credit agencies of this Government are now collecting more than they are lending for emergency purposes; emergency loans are in the process of liquidation.

We know what has happened in the real estate market, compared to what it was. Mortgages that looked worthless a couple of years ago look pretty good again. The loans the Government made through the R.F.C., the Home Owners' Loan Corporation, the Farm Credit Administration, and several other agencies, which looked very bad when they were made, are an entirely different picture today. A loan that is perfectly good on an \$80,000,000,000 national income looks very bad on a national income of \$40,000,000,000. The ability to pay debts and taxes relates to national income. Taxes are large or small according to the size of the national income, and debts may also be good or bad in the same way. So what we are primarily interested in is the maintenance of national income.

Building new homes

I agree with most business men and bankers that a budgetary deficit, if continued, will create inflation. We have re-established or restored our volume of money. Unfortunately, it is all too much concentrated, and will not be used in putting people to work until the buying-power and the demand for goods, generally speaking, will make industrial modernization and expansion profitable. However, one big field is open. That is the mortgage field for home construction which, if it can be gotten under way on a long-term, low-interest, amortized basis, would be the means of creating our next period of real business activity. The Government is attempting to stimulate some activity in that field through inducing the agencies that have the funds to lend them. The banks now have a large part of the unused time funds for lending and that is why banks must either get rid of their savings funds or put them to work. Insurance companies and mutual savings banks, of course, have large amounts of money. Those three agencies have lending capacities of several billions of funds for mortgages.

Balancing the budget--raising taxes

The reason that a continued budgetary deficit would create inflation beyond the control of the Federal Reserve System is that such a deficit financed by banks would continue to pile up bank deposits. The Government spends the money that it gets from credit extended by the banks, and the money gradually goes back into the profit system and is reflected in idle deposits. There was a tremendous increase in corporate profits last year, but very little increase in the average wage levels, nationally speaking, and the price levels have remained pretty stable, outside of the prices of farm

products and raw materials. You will see, therefore, that Government spending is resulting in a huge increase in idle deposits by corporations and wealthy individuals. It is a matter of logic that if we continue to build up idle deposits, it means that some time or other they are going to flow over, and when they do you will have a speculative inflation at least. The stock market up to the present has been financed very largely without the use of bank credit.

We must look to a period of balanced budgets. The matter of a few billion dollars more added to bank deposits would not be material because time deposits are substantially below what they were in 1929. But we must look in the next year or two to a balanced budget. Personally, I would like to see it by 1938. I think it can be brought about by an increase in the national income and in profits with a revision of the tax system somewhat along the lines that are now being proposed. I am in accord with the principle of the new tax proposals, although there are many of the details that I would take issue with. But to me the principle of forcing idle money in corporations into circulation is absolutely fundamental if we are to avoid inflation. That will tend to balance the budget.

Can we quit Government spending?

Many of us would say that the way to balance the budget is quit spending. That cannot be done and it should not be done so long as we have an army of unemployed people. You business men could not afford to have it done because a too rapid contraction of Government spending could easily precipitate another deflation. We have not reached a stage in our recovery where we can stand any such shock as the loss of that buying-power. Only as national income

increases and private spending and private credit expansion takes hold, can we socially, politically, or economically decrease Government spending by any great amount.

I am not speaking about the bonus nor about any other special legislation of that sort. I am speaking about unemployment relief and public works. I am not speaking about the methods of spending that have been used. There may be much difference of opinion on this point. Maybe we could get more for our money, or could spend it more wisely where it could do more good. But so far as the actual amount of money being spent is concerned, to try to spend less would only mean that there would be less buying-power and a lowered standard of living on the part of those unemployed, and God knows, generally speaking, what they get is not very excessive.

Dumping the unemployed

If we expect capitalism to have the right to draw from the pool of unemployed when the services of men can be used profitably and then to have the liberty to dump them back into the pool of unemployment again, then the rights and liberties of those men, who through no fault of their own are put on relief, must be taken care of by all of us through the Government. The only salvation of capitalism is to recognize that the cost of unemployment must be borne in one form or another by all of us through Government. The thing that we cannot afford is not the cost of relief of \$2,000,000,000 a year, nor is it the cost of a budgetary deficit of about \$10,000,000,000 in the last four years; but the thing that we cannot afford is the wasting of our great resources of manpower and idle facilities, the loss of \$40,000,000,000 national income in one year, such as 1932.

War debts

Do you know that the per capita debt in this country at the present time is less than it was in the year following the war, and that the per capita wealth is far in excess of what it was at the end of the war? Do you know that we had a deficit in one year during the war of \$9,000,000,000 and the next year of \$13,000,000,000; a two-year budgetary deficit of \$22,000,000,000. It did not bankrupt us. We reduced that Government debt during the period of the twenties by about \$10,000,000,000. While we were doing that, we added tens of billions of dollars of new wealth in new capital facilities of all kinds, and we made some foreign loans, and we reduced income taxes four times. So far as our physical capacities were concerned, we could have paid it all off and known little about it.

Summing up

I believe we can have a stable capitalistic democracy. I believe that it can be accomplished through recognizing that the Government is a compensatory agency in our present economy, not a competitor in the field of private business except possibly to extend credit in an emergency, but an agency to bring about better income distribution. When unemployment first develops, it is an indication of an absence of buying-power and this is a self-generating thing. That lack of buying-power must be met in the beginning by having a program of public works, so that we will not lose in our economy the value of the services of our citizens. In this way the unemployed will be used on socially beneficial projects which are not entered into because of the profit motive alone. We should divert Federal funds in good times to retire the Government debt held by the banks to offset

the private credit which the banks will be extending to corporations and others. That will be one of the most effective means of inflationary control that can be developed. In other words, the Government fiscal policy and the central bank policy, credit expansion and contraction should be coordinated. I think that within the Treasury and the Reserve System there is a real possibility of money management.