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NECESSITY OF COORDINATING FISCAL AND MONETARY POLICIES

I do not think anyone in the country is more anxious than I am to lessen or remove the wide swings in business activity that entail so much misery and social unrest. No problem facing our generation seems to me as important as this one. It was because of this feeling that I originally went to Washington. It was because of this feeling that I accepted the chairmanship of the Board of Governors. It was because of this feeling that I am continually urging the necessity of coordinating monetary and fiscal policies in a grand frontal attack upon this most pressing of all economic and social problems.

I should like to make it clear that I am expressing my own personal views and am not speaking for the Board of Governors or the Administration. The problem, as I see it, is not one of party politics but of economic realities. Wide swings in business activity occur in all capitalist countries regardless of the form of government and regardless of the party in power. When we are all agreed as to the desirability of the end, it would be most unfortunate to have the determination of the proper means become a matter of party politics and settled in the heat of a political campaign. There should be no Democratic or Republican solution. In my opinion, there is only one feasible solution and that should be equally espoused by both parties. Heaven knows, there are plenty of other things about which honest differences of opinion may legitimately exist.

I think that we have the knowledge and the means to achieve at least a partial solution of the problem of economic stability, but I also think that the solution cannot be achieved without widespread understanding of the elements of the problem and widespread agreement as to the proper course of action called for.

In order to place the problem of securing greater stability in its proper setting let me sketch for you very briefly a few of the more significant developments in the past ten years. In the first place, I do not think that the depression was caused by the malpractices of particular individuals or by the stock market crash. Such explanations are too easy and fail to take account of the stubborn fact that building started down in 1928 and general business activity began to decline before the crash. Moreover, they cannot explain the worldwide character of the depression. We have to look much deeper into our economic system to locate the real trouble.

I do not pretend to understand all that happened in the business world in the late Twenties. Certain facts, however, I think are highly significant. One fact is that corporations reporting net earnings in the period 1923 to 1929 paid out in dividends only $38 billions of their total earnings of $70 billions. The difference was in part put back into plant, which in some cases resulted in excesses; in part loaned to speculators, which weakened Federal Reserve control;

in part invested in other corporations, which tended to decrease competition; and in part added to cash balances, which tended to decrease consumer buying power.

The second significant fact is that a substantial part of the money used to purchase consumer goods was borrowed. The purchases of the mass of consumers were in excess of their incomes. When consumers either could not or would not borrow any more, the demand for goods was bound to decline. This is what I think happened in 1929. Buying power was becoming deficient in relation to our capacity to produce. When industry could not sell its output it immediately began to restrict its expenditure on capital goods, but every restriction of expenditures led to a decline in incomes and every decline in incomes led to a further decline in the demand for the products of industry. We had entered upon the vicious circle of deflation.

There were at least two other important factors contributing to the violence of the depression. In the first place, consumers, speculators, and corporations all set to work repaying their debts. But every time they restricted their expenditures in order to repay debt the demand for goods fell off, output diminished, and incomes were further reduced. Debtors were fighting a losing battle, since any portion of the debt they were able to pay off resulted in a further decline in the national income and made the burden of the remaining debt more crushing.

The other main contributing factor was bank liquidation. Due to credit contraction and bank failures the supply of deposit currency, the major portion of the purchasing power of the community, declined by one-third. When finally the depositors lost all confidence in the banks, the whole system collapsed.

These various factors, mutually intensifying, wreaked terrific havoc in our economic life. The amount of income produced declined from $80 billion to $40 billion, despite the fact that our population and efficiency were increasing and we had the finest industrial plant and natural resources in the world. At the beginning of 1933 it is estimated that 15,700,000 workers were completely out of work and that the majority of the remainder were working only part time.

Since 1933 the trend of business has been unmistakeably upward. Liquidation has apparently run its course and the capital market is beginning to function again. The national income has risen about 50 percent and with it has risen the value of all property, real estate, stocks and bonds. With the increase in the demand for goods, corporations are beginning to discover it profitable to re-equip and extend plant. With the rise of rents and real estate values individuals are beginning to discover it profitable to build new houses. We are now, we may hope, well launched on the road to full recovery.

What is the explanation of this happy change in our circumstances from the dark days of 1932-1933? It cannot be attributed to the efforts of private individuals or corporations. As I just pointed out, individuals and corporations are only now beginning to borrow and spend on durable goods. The explanation is, I think, perfectly obvious. The recovery is mainly attributable to the fiscal policy of the Government. It was the Government that poured $4,200,000,000 into railroad and financial institutions, set up machinery for the refinancing of billions of dollars of farm and urban mortgages, and by so doing stopped the terrific spiral of liquidation and bankruptcies. It was the Government that spent $7,800,000,000 since 1933 in public works, work relief, and straight relief. Besides discharging the community's responsibility to care for the destitute, such expenditures have operated to increase the demand for goods. More people were employed to make these goods and their incomes, in turn, were spent in large part for additional goods, It was the Government which through its new issues, subscribed to in part by banks, was mainly responsible for a restoration of the deposit currency wiped out in the depression.

In real terms, that is, in terms of the community's welfare and in terms of the production of goods and services, the Government's expenditures have not constituted a burden on the community. They have been a positive benefit. In money terms the cost has been surprisingly small, in view of the magnitude of the accomplishment.

The increase in the Government's gross interest-bearing debt from the beginning of the fiscal year 1934 to the middle of the fiscal year 1936 was $8.02 billion. The recoverable expenses of the Government, after making an ultra-conservative allowance of 25 percent for bad debts, amounted to $2.25 billion. The increase in the Government's cash holdings, including the Stabilization Fund, was $3.15 billion. The net increase in the debt, therefore, was $2.64 billion. Although absolutely this appears a large figure, it is small relative to the national wealth and the national income. Even after allowance for the payment of the bonus, which is not part of the recovery program, and a further deficit in 1936 and 1937 arising from emergency expenditures, the figure will remain small in relation to our debt-paying capacity.

The carrying charges on the total Federal debt have increased from $599 million in 1932 to an estimated $750 million in 1936, or only $150 million per annum. The carrying charges on the total Federal debt amount to less than 1½ percent of our present depressed national income, and to less than 1 percent of the national income of 1929. The carrying charges were a higher percentage of our national income in 1921-22 than they are at present.

The end of the deficits is now, I think, in sight. With the increase in the national income, tax revenues are increasing rapidly. If new taxes are introduced which yield the amounts envisaged by the President we should be very close to a balanced budget in 1937. The bold policy of stimulating recovery bids fair to be brought to a successful conclusion.

I have not recounted the highlights of the economic developments in the past decade for their own sake, but, rather, for the light they may shed upon the proper handling of the problem of economic stability in the future. The lessons or morals I would draw from our experiences are as follows:

In the first place, they point, at least to me, to the necessity of modifying our tax system in such a way as to facilitate the even and uninterrupted flow of money through the economic system. I do not know what the final form of the recent tax proposal will be but I am heartily in sympathy with the idea of making it more difficult for corporations to accumulate great amounts of cash. The prospects of securing a more even flow of money would be greatly enhanced if corporations could be induced to maintain a fairly steady proportion between their cash holdings and the volume of their operations.

In the second place, I most fervently hope that one lesson we will all take to heart is the wisdom and, indeed, absolute necessity of having the Government's expenditures vary in a direction counter to private expenditures. If the Government contracts its expenditures and retires debt when individuals and corporations are doing this also, then our problem is hopeless of solution and little can be done through monetary control. If, on the other hand, the Government acts as a balance wheel, restraining the flow of money on the upswing and expanding it on the downswing, then the prospects are immeasurably better of securing at least a moderate degree of stability.

The final lesson I would draw from our recent experiences is the absolute necessity of conscious and deliberate control of the supply of money in order to forestall as far as possible excessive expansion or contraction in the volume of the community's expenditures.

If we have learned the importance of coordinating these three instruments of policy we may be nearer than we have dared to hope to the ideal of a more stable economic life. If, on the other hand, we have learned nothing and refuse to make any effort to achieve stability, then I think we will deserve the breakdowns and disruptions that will surely occur.