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March 20, 1936.

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3/27/36

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.

If some of the things I have to say appear dull or unpalatable, I am sorry. I can only plead that I do not find the question a simple one and that just because it is a community and not a private matter it calls for a different type of reasoning and treatment than is applicable to a person's private business.

I should also 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.

Let me, then, state the problem. I think that if this can be done clearly the solution almost suggests itself. In the first place, our economy is a money economy and a profit economy. Booms and depressions are monetary phenomena, not so much in the sense of being caused by variations in the supply of money as in the sense of working through and showing themselves in variations in money spending.

A large part of the difficulty of understanding how our system works, and why at times it doesn't work, is due to our inability to see the thing as a whole. If we could only get far enough away from the system to gain perspective, many bewildering phenomena would, I think, become clear. Suppose we were able to see the thing as a whole. At first we would see a bewildering variety of money and goods transfers. If we looked more closely, however, we would begin to see broad streams of money emerging. We would see checks and currency

flowing in one direction and goods and pieces of paper called stocks and bonds flowing in the other. If we looked still more closely we would see that the direction of money flow was from consumers and investors to agriculture, commerce and industry, and from these back again to the ultimate factors of production -- labor and to the owners of land and property. Another flow would be from individuals and institutions through the Government to other individuals and institutions.

Let us now suppose that we were in a position to observe the behavior of our system from 1928 to 1933. What would we see? In 1928 we would observe many eddies and whirlpools in the money stream, particularly in New York, but we would also see some \$80 billions being disbursed by business and this money used to purchase the current production of the country. Along about the middle of 1929, however, we would see a peculiar thing happening. The broad streams of incomes and production, which have been growing steadily up to this time, appeared to falter. A little later we would become conscious of a sudden contraction in the streams -- a contraction that continued for three years until both the money stream and the goods stream had been cut in half.

Interested in this strange phenomenon, we would look more closely and try to see if we could locate the source of the stoppages. We would look, first, at the great army of consumers but would not find the answer there. They were, by and large, passing along the money as fast as they received it. We would then turn to the few individuals who

appeared to be getting large incomes and who customarily turned a large portion of them over to other people in exchange for stocks and bonds. We would then observe something wrong. Instead of individuals turning money over to corporations in exchange for bonds, corporations in many cases were turning money over to individuals in exchange for bonds. A stoppage in the stream was occurring. We would then look at corporations and observe that instead of passing along all their money receipts to the factors of production they were using a portion of them to redeem loans and bonds. When they did this at banks the money generally went in but never came out. Here and there, with increasing frequency, banks were closing their doors and were drawing more money from the stream of circulation.

By 1932 we would have observed that the broad stream of money that had formerly flowed to the factors of production engaged in maintaining and extending the community's stock of capital goods and consumers' durable goods had practically disappeared. We would have been confronted with the strange phenomenon of two apparently inconsistent things existing side by side -- on the one hand, a country letting its plant run down due to the almost universal existence of unused and excess capacity, and, on the other, a desperate need for more goods.

Now, gentlemen, although my account of the course of events from 1929 to 1933 is highly simplified, it is, I think, substantially correct. We may not be able to see these money and goods streams, but neither can we see that the world is round. In both cases we have to infer their

existence from numerous factors that cannot be explained otherwise. We do know that through bank failures and credit contraction our supply of deposit currency decreased by one-third in the depression. We know that while the supply of the necessities of life, such as food, shoes and clothing, kept up very well, the volume of private construction, from which a substantial portion of the income of the community is earned, shrank from \$9 billions in 1928 to \$2 billions in 1932. We know that instead of borrowing and spending the current savings of investors our non-financial corporations reduced their indebtedness by some \$2 billions from 1930 to 1933. Finally, we know that despite an increase in population and efficiency our national income diminished from \$81 billions in 1929 to \$40 billions in 1932. Instead of a stock of money of \$27 billions being turned over three times a year to income receivers, we had a diminished stock of \$20 billions being turned over only a little over twice a year.

It becomes apparent that the problem of getting a decent degree of stability in our economic life is synonymous with the problem of keeping up and gradually augmenting the broad stream of money flowing from producers to consumers and investors, and from consumers and investors back again to producers. If we can keep up this money stream we need not worry too much about the goods stream. Private initiative and enterprise will turn out goods efficiently if there is a demand for them.

We may narrow the problem somewhat. We have seen that the stoppages occur not by the great army of consumers but in the stream of money destined for capital expenditures. The problem of stability boils down in very large part to the problem of getting the savings of individuals and corporations spent at an even rate in the making of capital goods. The more industrially advanced the country, the more savings there will be and the greater the degree of contraction and expansion of expenditures that can occur.

This, then, is the problem. What can we do about it? Let us first examine the possibilities of monetary control. The Board of Governors of the Federal Reserve System, in conjunction with the Open Market Committee, possess a high degree of control over the volume of money. It has been frequently objected, however, that this power is largely nullified by our inability to control the rate of spending of money. That, it is said, is purely an individual affair. This is partly but not wholly true. At certain times and in certain circumstances the monetary authorities may exercise a degree of control over the rate of spending. By increasing or decreasing the supply of money we can affect the rate of interest and the availability of loans to borrowers. In this way we can affect individuals' and corporations' decisions to save and to borrow. The degree of influence that can be exerted depends, it is obvious, on the importance of the rate of interest and the availability of loans in the calculations of savers and borrowers. If business is going along smoothly, this factor may be important enough to enable the monetary authorities, if they have sufficient

wit, to keep the stream of savings and capital expenditures flowing steadily. If, however, business takes a nose dive, the cost of borrowed money becomes a minor factor in the calculations of producers, and there is little that the monetary authorities can do. It is also obvious that if business corporations build up great holdings of cash at one time and draw them down at another, the problem of keeping up an even flow of money becomes more difficult.

It is considerations such as these that have led me to stress the importance of directing the Government's fiscal policies in a way to contribute towards stability rather than to intensify business fluctuations. We all recognized during the depression that if we all started borrowing and spending the downturn would be arrested and we would start upward. You will remember that we were exhorted to do so by placards and bill posters. What we failed to recognize for a long period was that the Government was all of us and that the only effective way in which we could all safely borrow and increase our expenditures was by doing it through the Government.

When we finally recognized this and increased expenditures, both the community's money and goods streams began to increase. It would have increased much more if so much of the new money had not come to rest in the accounts of wealthy and institutional investors and industrial corporations. There are at last, however, signs that the money stream

is beginning to be fed by private expenditures on plant and construction. As the stream increases from this source, the contributions of the Government can diminish. At a much later stage it may be necessary to check the growth of capital expenditures.

This can be accomplished in part by forcing corporations to distribute their earnings to their stockholders, in part by the Government collecting more of the incomes of the wealthy to retire the national debt, and in part by restraining action on the part of the monetary authorities.

I am convinced that if people once fairly grasped this monetary flow concept that I have been discussing they could not fail to see the necessity of coordinating the monetary policies of the Federal Reserve System with the Federal spending and taxing policies. By a proper coordination of these policies I am convinced that the variations in the money flow can be kept within tolerable limits. I cannot impress upon you too strongly that our greatest danger is not in incurring a Federal deficit when private expenditures contract, but in curtailing our collective expenditures at the same time as we are curtailing our private expenditures. Similarly, the dangerous course is to encourage corporations to build up great cash holdings which they can disburse in the future, as we do now, rather than seek to induce corporations to maintain a steady relation between their cash holdings and the volume of their business. Finally, the most dangerous



course of all is letting Nature take its course in monetary matters, rather than in controlling the cumulative variations in the supply of money with the objective of keeping the monetary circulation gradually and steadily increasing. If we can only secure a proper coordination of fiscal and monetary policies and direct them in a compensatory rather than in an intensifying direction, we may be much nearer to the solution of our problem than we have perhaps ever dared to hope.