

Transcript of notes taken on statement made by Chairman Eccles at meeting of the Board with Presidents and Directors of Federal Reserve Banks in Washington on March 2, 1938.

(No notes were taken on the opening sentences of the statement.)

Agriculture is likewise becoming better organized and has of necessity brought about more rigidities and has placed upon Government increased responsibilities in order to keep the economy going. During the period of the 20's when we were not subject to the controls that we have been subjected to since and business in particular was left more to its own devices, particularly in the field of financing, we know that that did not ultimately turn out -- that freedom of action -- to be in the public interest or ultimately in the interest of business, agriculture or labor itself.

The increasing power of Government in a democracy is gotten only through the will of the people. Some of us may not like some of the things that are done but the essence of a democracy is an expression on the part of Government of what they determine to be the will of the majority. The Government is forced to enter into certain programs which have been termed undemocratic and un-American. Many of the programs which they undertook were forced upon them and many of the things that have been adopted and the changes that have been made are going to be with us no matter what political party may be in power in the future. The underlying problems, of course, are economic problems. Our political problems, as we look through them, are economic and social problems and the problems we are confronted with today -- that each other democracy is confronted with -- are problems that any future Government likewise is going to be confronted with. They may meet these problems in different ways but they will try to meet them in the ways that they conceive to be the will of the people. When I face the problem from that standpoint I feel more willing to adjust my own point of view than I otherwise would be.

Inherently I am an individualist but I see the necessity of the business interests of the country changing many of their former points of view. It is an easy thing, of course, to know what our individual desires are with reference to what we would like to see done as it relates to our own particular situation as we see it. But I am sure that if any of us were put in a position of great public responsibility we would waive aside our own individual feelings in the matter and would be very cautious to act only as we saw the public interest even if it were contrary to what we might hope the situation called for.

The essence of a capitalistic democracy is a certain amount of freedom of action -- not so much freedom that we destroy the democracy and yet not so much restraint that we may likewise bring about its destruction. We are in an interim period in our economy -- in somewhat of

a no-man's land -- in which we are somewhat groping in order to find formulae that will so modify the conditions under which we operate, and which have failed in the past, as to give us some assurance that we can go forward in the future. The function of Government, as I see it, is that of coordinator in the public interest -- is all of us acting and doing what we are unable to do for ourselves. I would like to see as little regimentation -- as little direct regulation of the activity of the individual as possible. I would like to see the Government's function to be that of the compensating factor in the economy through functional methods.

We note that the volume of money (and by money I am speaking of it in the broadest sense, i.e., bank credit as well as currency, together with its velocity or turnover) is the direct factor that determines the volume of business and has a great deal to do with the price level. From 1929 to 1933, with little Government interference, with little to disturb confidence, with little to create fear, we possibly saw, when business interests, farmers, and all of our citizens were left to their own devices, a period of the greatest lack of confidence and the greatest amount of fear that we have seen in this country, certainly during my lifetime.

Business moves, undertakes activity, because it feels that it has an opportunity to make a profit. During that period of time we saw the supply of the means of payment greatly diminished through the liquidation of bank credit and the closing of banks and with the diminution of the volume of money we also saw a great contraction in the velocity or turnover of money, so much so that the national income was cut in two and the difference between the wealth produced in 1932 and 1933 and that produced in 1929, with practically no Government interference in the meantime, equals about \$40,000,000,000 in one year. The income was so low at the bottom of the depression that the debt structure was entirely unsupportable and we know what happened to a lot of it. The Government did not come into many fields of activity because it chose to but because it was forced to to save the economy. How could it come into the picture and help? It had to come in by increasing the volume and velocity of money. Any device on the part of Government that does not influence the flow of money cannot in any way help the economy. That is basic.

In answering Mr. Thorpe on what the Reserve System can do, we can create excess reserves. The Reserve System did create excess reserves through open market operations in 1933 and 1934. Great quantities of gold came into this country as a result of effecting a transfer of foreign capital which added to the reserves. Merely putting the banks in a position to expand credit and thus expand the means of payment did not of itself bring about an expansion of credit because the expansion of credit is dependent upon the desire of borrowers, of business generally, to use the credit and if a condition does not exist where business finds it profitable to use credit, all of the excess reserves in the world are not going to help. Even if they could borrow money for practically nothing, as many

of them can today, they are still not going to assume a liability. Therefore, the Reserve System in and of itself beyond creating a condition of easy money -- putting the banks in a position where they can extend credit when they are called upon to do so -- beyond that, there is little that the System can do directly.

The Government did come in and did increase the volume of the means of payment and did increase the velocity because they did what the individuals and corporations were unwilling to do. They could take a risk because it was all of us, using our credit through Government for social purposes whereas the individual business and individual only would do so because of a profit motive. There was the deficit financing that put an increased means of payment, an increased volume of money into the spending stream that primarily, in my opinion, changed very greatly the condition.

I am not going to defend the manner in which a Government might do that or did do it. There could be a difference of opinion as to how Government credit may be used in influencing the volume and flow of money. It can be done in a way that would stimulate business more in one manner than would be the case otherwise. A Government can spend money in competition with private business and thus stop private business from undertaking activity in that field in which it is faced with Government competition. I have in mind particularly the utility field. The expenditures that Government made in that field without a clear division as to where Government activity stopped and private activity started without question influenced or retarded greatly the expenditure that private industry in the utility field might have made. Very likely the money that Government spent might have resulted in a greater amount of business, of activity, sooner than it would had it been spent in other ways. After all, we are in a democracy, a political Government, and all things that are done are in the nature of a compromise. We must realize that and not be too critical.

We have seen that in spite of these taxes that we have heard something about today and in spite of other restraints and restrictions that were expected to retard business activity, that during 1936 and early 1937 business activity, if anything, went forward too fast and not too slow. It went forward so fast that we ran into bottle necks. We reached the point where they were operating at capacity and there was a scramble to expand their productive facilities. There was an opportunity apparently during that period for a profit in spite of these taxes that we hear about. I don't believe that the taxes that were in effect had anything to do with the recession, generally speaking. I wish it were that simple that by elimination of the tax we could correct the problem. We didn't have the taxes during 1929, during a great depression, but we did have them in '36 and '37 during a period of real business expansion.

In 1936 the Government was responsible for adding to the community buying power which was a tremendous factor. The Government contributed

during 1936 to community buying power over \$3,000,000,000, measured by the difference between what the Government pulled out of the community and what it paid out to the community, including the bonus, by way of expenditures. That added very greatly to the supply of money. It added to the supply of money too fast because in this particular period business could see an opportunity for profit and was using bank credit. They were creating a means of payment simultaneously with the Government adding to the means of payment very rapidly. The Government, in other words, should have reduced sooner than it did its contributions to the community buying power. As I have said at different times, the bonus was paid at the wrong time. It should have been paid in 1934 and not in 1936. It amounted to nearly \$2,000,000,000 being injected into the spending stream when the Government was spending about 1-1/2 billion dollars for relief and other things more than it was taking in when private business was also expanding it by the credit it was creating. We therefore in 1936 had a tremendous addition to the volume and velocity of money, particularly to the volume. It is a case where Government as a compensatory factor in a functional way could have, I think, if it had been wise enough, if it had understood the problem, the monetary aspects of the problem over which the Reserve Board has no control, it could have prevented the inflationary psychology that possibly developed. Not that prices were too high but many of them were going up too high. The general price level has never been too high, but some prices were certainly too high in relation to others and there was a great disequilibrium of prices that developed. This developed in the capital goods field. Just that field that was expected to take the place of a reduction of Government expenditures -- the housing field, the railroad field, particularly. When neither of them were expanding more than possibly we would have reason to expect they began to turn down, due to a labor problem and a price problem and that has done more than any other one thing to bring about this recession.

It is my honest opinion that we are not going to get a recovery by leaving the economy to its own devices. If it is, it is going to be slow. The national income at the present time is possibly not exceeding \$55,000,000,000 as against \$68,000,000,000 last year. We are losing about 13 or 14 billion dollars a year in real wealth because of unemployment and idle facilities. That is a loss that we just cannot afford. I doubt that the debt structure is such that it is supportable on the basis of the present income. We must increase income beyond \$55,000,000,000 or there will be an increase of bankruptcies and defaults which will only tend to precipitate the deflationary trend.

We talk about an expansion in the capital goods industry. We know that is the part of the economy that does more than any other one thing to make for our peaks and our valleys. We go along for a period and the capital goods industries operate on a profitable basis, a basis of normal near capacity and we then have a record of reasonably full employment without the Government doing very much by way of providing employment. The minute we reach a point where consumer buying power is unable to buy what industry can produce -- in other words, the balance between savings and consumption gets out of joint -- a recession begins to develop.

The real problem is one of attempting to maintain a better balance between consumer buying on one hand and savings which represent capital expansion on the other. In that place is where the tax system is vital. It has been used in other countries as a means of bringing about a better distribution of national income. The total income tax is greater in most all of the foreign democracies than it is here. In spite of those high taxes there is a problem today being confronted in most of those countries, Switzerland, Holland, Sweden, and Britain, seeking an outlet for their savings. In spite of taxes the amount available for capital expansion has exceeded the opportunity to invest those funds and they are looking abroad. They are making loans abroad wherever they can find an opportunity. If we are willing to take such capital accumulations as we have and can find an outlet abroad and are willing to loan them we could possibly get along for an indefinite period because the funds then would be going to work and as they went to work it would put them into circulation and would provide buying power in the export market. That is one of the important factors that kept us going in the 20's. We don't have the same factor today and are not likely to have it.

In the absence of that; query: Should we permit business to accumulate earnings and keep them idle? That stops the flow of money. It means that business takes more dollars in than it pays out and when it does that, if it is good for one business it is good for all business. If all business takes in more than it pays out, what does it do to the spending stream? Unemployment would soon develop and the Government would be required to pay out more than it takes in, which means deficit financing. We know that expansion comes only by the increasing of debt by the banking system or through more rapid turnover of funds that have been created by borrowing. All funds are created in that manner, whether Government or private. If business activity is brought about, which we know it is, by the borrowing of funds, then if business does not want to borrow but wants to be free of the tax so that they can get out of debt and thus diminish the supply of money, Government must then operate on a deficit to supply the deficiency that business creates.

Every period of business improvement has been brought about by an increase in business credit or Government credit. Business today is saying that what they should be permitted to do is to keep their earnings and use them to get out of debt or use them for a rainy-day reserve which means to keep them idle or on balance as only the business can put the funds into circulation. On the other hand, we are all advocating the opening up of the capital market which means the going into debt by some one, which means the very counter of the creation of a rainy-day reserve. We are advocating that the individual borrow money to build houses and we have provided a mechanism to give them up to 90% on a low-cost house for twenty years at a 5 % rate. Is that good for the individual who has no access to credit during periods of unemployment, who has no assurance of employment? If it is good and we advise it, how can we consistently say that we should be permitted to take the earnings that we get during a period of good times and

pay off our debt and thus extinguish the supply of money and at the same time ask that the Government pay off some of its debt and not create new money? It seems to me that our thinking on that point is not very clear. At least the arguments I have heard for it, and I have heard all of them, are certainly not convincing. Business gets out of debt and Government goes into debt during periods of recession. Business should go into debt during periods of business activity and the Government should undertake to reduce its debt.

I am in favor of the present tax in principle, both capital gains and undistributed profits tax. Some modifications are necessary and justified from a monetary point of view, and I am speaking of it from just that. The little business might well be given an exemption. Or a small exemption of 15 or 20 thousand dollars might be given to all business, first because it doesn't amount to much, second, the little business doesn't have access to the market, and third, it is owned on the average by little people, people with small income and the normal income tax, much as it would be as a partnership. Therefore, there is no advantage and it would be equitable. I would like to see business exempted from undistributed profits tax to the extent that the money is spent. Not to the extent that it is used to build up idle balances, but to the extent that the money is put back into circulation and we don't make way for a depression. I would refuse to give them an exemption to the extent that the funds were used in the acquisition of existing properties which might leave them idle.

The failure of an undistributed profits tax had more to do with the market boom than any other thing I know of. Idle money tended to create speculative excesses. If these funds were put back into plant and expansion beyond the depression reserve, that would give a flow to the funds and tend to continue to maintain stability. We might also permit business to pay off its total indebtedness on a basis of not to exceed ten per cent of what that indebtedness was. Then you would not get the great volume of liquidation. If a business could then pay off up to say ten per cent of its indebtedness, we would have reason to expect that it would be offset by expansion of credit to other businesses. Beyond that I would tax a business that did not pay out its funds -- if it hasn't used them for expansion, hasn't used them to pay off a debt not to exceed ten per cent. Then I would put a very high tax on the funds that were held idle. I would attempt to force those funds into circulation because the velocity of money is fundamental in this economy.

We had a huge capital expenditure in 1936 when we say the capital market did not do anything. It didn't do much. New offerings were small, and yet the total volume of capital expenditures in 1936 and 1937 were very large, especially in industry and mining. It was large because business did not go to the market for funds. They took existing idle funds and put them into circulation without the use of credit, and you may be interested to know that of a study of 213 of the largest corporations in this country,

their cash from 1925 to 1929 rose from 1-1/2 billion to 3 billion dollars. They added to their cash during that period or its equivalent 1-1/2 billion dollars.

When the recession came, what happened? Were those rainy day reserves used to give employment? If they were, you would expect a large contraction in the balances of these companies and these funds would be expected to go out into circulation during that period and thus tend to maintain the economy on a more stable basis. But that is not what happened. Business showed terrific losses, but they did not show on an average but a small reduction in their total cash balances. At no period from 1929 to 1937 did those cash balances fall below 2-1/2 billion dollars. They were higher in each year since 1929 than they were in any year prior to 1929. Those were the funds that were lying idle in the banks during the depression and they were the people who were condemning the Government for putting money into circulation that they were unwilling to use, not because of Government regulation, but because there was not a profit motive for it. When deflation comes, your inventories are liquidated and you get cash instead of inventories. You get cash in lieu of accounts. You take depreciation and you don't spend it and thus money becomes idle and piles up. Business must face the fundamental factors that tend to influence the volume of money and velocity of money from the standpoint of business, and not from their own individual standpoint. It is a fine thing for me as an individual and my business individually, and I will always attempt to get out of debt or keep out of debt. But, for the economy as a whole, it is decidedly bad and the Government has got to come in and act as a compensatory mechanism in the economy, and there is no other way out of it. There will not be, in my opinion, any substantial expansion in the capital goods industries without stimulation of action on the part of the Government in spite of the fact that the volume of money now created and on deposit in the banks is as great approximately as we have ever had in this country because that money goes out when there is an opportunity for a profit. You know the condition of the railroads. You know there is little prospect for an expansion in their capital goods without some stimulation on the part of the Government. They have idle cars and idle locomotives. Even if they had money, and many of them still do, and could afford to make investments, they will not do it. Why? Because the volume of traffic must first increase. There is far less pressure on the utilities today than a year ago because there is less traffic than a year ago and expenditures would be very much less even though there were an approachment between Government and the utilities. At best you couldn't expect any greater volume of funds to be expended in that field, and not quickly. In the automobile field we know that we have reached a point of saturation unless the national income gets up to \$80,000,000,000. That would support an increased volume of cars. We may get replacements, but we are not going to make a total addition to the total automobiles until we first build back a national income beyond what we had last year. There is every prospect that there will be 2,000,000 less automobiles produced this year than last year which will reach close to \$2,000,000,000 decrease in employment and money in circulation. Industry, during 1936 and 1937, spent on capital account as much as it spent on capital account

in any year except 1929. The plant and facilities of industry in this country are now in a position to produce goods on a basis of a national income of \$70,000,000,000. They largely put themselves in that condition. In housing where there was a shortage last year there is now an excess. That is a relative thing too, like automobiles, and has a relation to unemployment and national income. Last year people could afford to pay more rent and the economy could afford to take a lot of obsolescence. Today it can't. What was a shortage will become a surplus. Rents will go down in most places unless there is some action on the part of the Government.

Take the foreign field. Our export business is getting less because our imports are less, and they are less because our national income is less. We are not buying many things from abroad today because of a diminution of the national income and hence our exports are affected by our imports over a long period. As the depression exists here there will be less foreign remittances and travel abroad to buy our goods.

I would like to see us be willing to approach this problem not as a means of pump priming in the sense that we pour billions of dollars in at the consumer end and pay consumer funds to do unnecessary public works. There are too many things that have real economic and social values that we could do. I think that in the housing field we could well afford to give a subsidy in order to move that forward. Germany did, and in many instances they paid the cost of demolition so as to make place for new structures. It would be a similar situation if the Government bought up a lot of old automobiles and demolished them. That would create a greater market for new cars. The funds the Government paid out for that purpose would go into circulation. If the Government, by the expenditure of \$1.00, can stimulate the expenditure of \$5.00, that would be valuable. The Government could well afford to take the railroad picture today and could possibly undertake the purchasing, through a corporation, of a lot of standard equipment. It is estimated that the railroads will need over the next three years, if we get a normal recovery, \$3,000,000,000 of equipment. What will happen? They will start buying that equipment and they will want delivery in one year, and you will get a shortage of labor in certain fields and the equipment and steel mills will reach beyond capacity and you will have another peak. If the Government could buy at the present time, placing orders over three years and stabilize the industry, leasing to the railroads, pooling the equipment probably, railroads would have to lease it, rather than buy new, or would have to buy it. That is a type of place where the Government would not interfere with the individual beyond acting in a way to stabilize the market. The Government could give a subsidy in housing so as to stimulate volume in that field and reduce costs. F.H.A. could appraise the properties at low prices. They could appraise them very conservatively and tend to force our whole cost down to get the subsidy which could be used as a means to keep the cost down.