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We are accustomed to hearing so much criticism of our economic and political system that we sometimes forget what has been accomplished under it. Yet no other form of human association and endeavor has produced the benefits to all classes of people that have resulted from this system of representative government and of private enterprise under which individual initiative, in the creation of new inventions and the production of new material comforts and all of the countless things that go to make life better, has flourished as it cannot flourish under any form of regimentation or dictatorship.

As one of its beneficiaries, no one is more desirous than I am of preserving the system that has made possible this country's amazing development and progress, nowhere more evident than in this great city of millions of people. If we are to preserve this system and encourage it to reach still greater heights of human advancement and accomplishment, it is essential that all who are in places of responsibility in banking, business, labor, agriculture, and government, understand the nature of a capitalistic democracy, in which the dominant incentive to individual initiative is a profit motive.

The three main factors necessary for the creation of real wealth are man power, natural resources, and capital, of all of which we have a greater abundance than we have yet learned how to utilize fully and continuously. How may these elements be combined most efficiently and effectively to produce a steadily rising standard of living for all of us under our system? It seems to me to be evident that, first of all,

every possible opportunity must be provided for individual initiative--for capital to find profitable outlet in the production of a maximum of goods and services and for labor to have continuous, profitable employment. Neither capital nor labor can be expected to function otherwise, and when they fail to produce, the nation suffers irreparable loss. That is the kind of waste which we can least afford. The opportunity, therefore, to realize a fair return is of first importance. For capital this must make allowance for investment and risk-taking. For labor it means, in the broadest sense, the ability to purchase the goods and services which the economy is capable of producing. For the farmer, it means that he must receive a return upon his services and investment reasonably commensurate with what capital, industry and labor receive.

To my way of thinking, the role of the Government, which is not animated by the profit motive, should be that of a coordinator, to adjust and adjudicate conflicting interests so that they will not result in injury to the public. The Government must be impartial. It must be representative of all of the diverse elements of the country and not be moved by favoritism towards special interests. In striving to prevent or to correct abuses, or to remedy maladjustments that inevitably develop under the free competitive interplay of economic forces, it must not resort to punitive or coercive methods. Such methods destroy confidence in the Government's impartiality and tend to paralyze the initiative vital to private enterprise.

While the practical application of these general principles to the complex problems of today is far from simple, the principles do not change though the problems do. So far as I am concerned, I am not willing to abandon the principles, but I am conscious of the necessity for constantly adapting and improving the mechanisms for dealing with changing conditions domestically and internationally.

I think that most of us, as never before, are concerned about the future--about the future of capitalistic democracy. We hear it said that democracy is challenged by dictatorships, that it is on trial today, that it fails to meet fundamental needs for a maximum production and distribution of goods and services, as is evidenced by the millions of men and women, citizens and voters, who lack an opportunity for profitable, private employment and are supported by public or private charity or by made work. For nearly ten years, it is true, our own country has been unable to maintain a national income anywhere near up to the high levels of which it is capable. Yet I am sure that all of us here believe that only under a democratic, capitalistic system can we ultimately secure the greatest degree of well-being and human happiness for all of our people.

We can and we will meet that challenge, successfully, by making our system function so that every able-bodied citizen who is willing to work will be able to find profitable employment in private enterprise upon which our system depends. When I consider past achievements, the contributions made by American initiative and enterprise to the economic

and industrial development of the country, I feel that there can be no justification for discouragement, if we all will quit calling names, if we will generate more thought and less heat, and set ourselves to the task of understanding the nature of the economy in which we live.

What we seem to lack is sufficient understanding of the nature of the capitalistic democracy under which we desire to live. We cannot have a system of laissez faire, even if we would, if by that we mean that the Government should be passive, letting nature take its course and doing nothing to moderate the destructive extremes of ruinous inflations and self-accelerating deflations. It may be that such extremes are self-correcting, but if so, in our complex economy today, it would be at a cost that I do not believe the people of a democracy would tolerate. We must not have a completely controlled economy. That would be regimentation, not capitalistic democracy.

What, to my mind, we can and should have is the fullest possible encouragement to private enterprise upon which our system essentially depends. Private enterprise, business, industry, agriculture, have always, even in the depth of depression, provided employment and income for the overwhelming majority of our people. At best, Government, through relief, made work, or otherwise, can hope to provide for only a relatively small proportion of the total. Certainly we cannot substitute government for private enterprise and still have our system.

It follows, therefore, that the basic objective of national policy should be the maximum encouragement to private enterprise so that it may furnish the greatest possible employment and the greatest possible production and distribution of goods and services. To this end, it is

essential that Government shall not, as a general principle, discourage, displace or undertake to compete with private enterprise. Having given the fullest encouragement and opportunity to private enterprise, then it seems to me that the Government has a responsibility in a democracy to provide for those for whom private enterprise has failed or is unable to provide.

That this is a collective responsibility, that private enterprise cannot be expected to assume it, and that the Government alone is able to assume it, seem to me to be inescapable conclusions. I shall not undertake here to go into the question of how the Government should discharge that responsibility, but I want to emphasize the importance, as I see it, of a clearer recognition of the fact that in a democracy business and industry cannot sensibly object to having the Government provide for those for whom private enterprise does not make provisions, if Government has first given private enterprise every reasonable opportunity for profitable operation and for giving employment.

Beyond the fact that, as I view it, no other course is possible in a democracy from the standpoint of political, social or humanitarian considerations, I am convinced that there are sound economic reasons which should appeal to bankers, industrialists and business men generally, why the Government should maintain a volume of expenditure necessary to sustain consumer buying power. We know only too well from experience of the variability of employment, and hence of buying power. Our objective is the highest possible degree of sustained employment, and I cannot re-

gard as either novel or revolutionary the theory that as private employment diminishes, from whatever cause, the Government can in part compensate for it by increasing expenditure.

It seems to me that our banking and business leaders who are concerned about the preservation of our institutions, who do not want regimentation or dictatorship, may well consider the possibilities of and lend support to government policy designed to offset economic extremes and to stabilize economic progress. I feel that, functionally, the Government through monetary and fiscal policy, through taxation, through budget and other policy, can do much to make economic progress smoother and steadier, with the main objective always of a maximum of employment in private enterprise. I realize that many of the older generation who were brought up under other economic conditions and other rules, which may have sufficed for those times, are reluctant or unwilling to accept the idea that Government should assume such broad responsibilities.

The bankers of the present day, I am convinced, cannot in their own interest fail to face the alternatives presented by radically changed and rapidly changing conditions today. They must recognize the nature of the banking function in relation to the economy as a whole. The primary purpose of the banking system is not simply to provide a safe place for people to deposit their money. That is a secondary consideration. The broader purpose of the banking system is to play a vital part in the process of production and distribution

of goods and services. This part consists of creating and maintaining an adequate supply of money, that is, of bank deposits, which we use for money in most of our transactions. It is commonly believed that a bank, in making loans or investments, merely loans or invests its deposits. This is largely true of an individual bank, but the banking system as a whole creates money by its lending and investment operations. Conversely, when loans and investments decrease, deposits, that is, money, decreases correspondingly. Because of this function of creating money, the banking system as a whole plays a role of the greatest importance in the functioning of a debtor-creditor economy.

You are well aware of how after 1929 the supply of bank money diminished rapidly as deflation proceeded. As loans were collected and investments were liquidated, the supply of money correspondingly diminished. This process continued until 40 per cent of our volume of bank money had been extinguished, and at the same time the turnover or velocity of the supply diminished. You are well aware of the accompanying disturbances; of the enforced sale of inventories; of constantly reduced prices; of the stoppage of all capital expansion; of the steadily shrinking or vanished market for practically all securities. Even 3 per cent government bonds sold down as low as 83 at a time when the national debt was half of what it is now.

The solvency of innumerable banks was destroyed. Currency was hoarded on an unprecedented scale. Nearly one-third of our able-bodied

workers were forced into the great army of unemployed. The solvency of our insurance companies was impaired and confidence in the dollar, both at home and abroad, declined. The incomes of our investing classes were destroyed or greatly reduced. These processes, instead of bringing about confidence and liquidity, undermined both to a point where the entire banking system collapsed and precipitated the bank holiday.

This situation, let me point out in passing, brought about high interest rates, which some of my banking friends feel are essential to our well-being. What caused the high interest rates at that time? It was because the supply of money was rapidly diminishing and the opportunity to make good loans became more and more limited. This condition did not protect the savings of our people. It largely destroyed the income of debtors, individual and corporate, thus bringing about innumerable defaults and making it impossible to pay any return on countless bonds, mortgages, and other investments representing our savings.

We learned that deflation is as disastrous as inflation. Loans and investments which were perfectly good during the period of full employment when the national income was high became temporarily bad when the national income fell from $80 billions to $40 billions a year. We had the high interest rates but that did not protect our savings or protect the depositor. We also discovered that although tax rates were lower then than they are now, the tax burden then was far heavier in relation to our ability to pay. The Government made desperate but unsuccessful efforts to balance the budget, and did nothing to "destroy confidence", but there was no confidence.

I do not wish to censure the individual bankers for what they did, for they could do nothing else if they wanted to keep their banks open. What was required, however, was collective action on a scale which only the Government could undertake. You are familiar with the various actions taken to meet the emergency situation.

If the Federal Reserve System could have loaned then as it can now on any sound asset, on mortgages, bonds, collateral loans and other bank assets, the pressure could have been greatly relieved. But the Reserve banks were restricted to lending on a narrow range of technically liquid paper. As a basis for help, this was soon exhausted, and the banks were then forced to dump their other assets on a distressed market which was made worse by the unloading. It ought to be clear from this experience that the individual bank cannot provide its own liquidity, nor can technical rules provide it, except by restricting the banks to super-liquid commercial paper and government bills, the supply of which is so limited and the yield so low that the banks could not survive if their earning assets were confined to such paper.

Testifying in connection with the Banking Act of 1935, I undertook to point out the dilemma that faced the banks. I said then that, "If they go into the longer term lending business, they run the risk of depreciation and of inability to realize quickly upon their assets in case of need. If they do not go into this business, they cannot find an outlet for their funds. Their earnings will suffer and the justification for their existence diminishes."

It seemed to me then, as it does now, that the dilemma has to be solved by allowing the banking system to adapt its credit policies to current requirements of the community, particularly in making longer term, amortized loans. I was gratified to note the recent report of the Reserve City Bankers' Association on this important subject. With this general purpose in mind, I had advocated in the Banking Act of 1935 a clear recognition of the principle that liquidity should be provided collectively, not by individual banks confining themselves to super-liquid commercial paper, but by the Reserve banks being in a position to lend on all sound assets. Thus the emphasis would be taken off the variable yardstick of fluctuating market values and put where it belongs on true worth, measured over a longer period and by broader experience. At a time when the normal security and money markets are demoralized, the Reserve System is the only means whereby liquidity can be provided because it can convert sound but temporarily unmarketable assets into money.

One problem which concerns you as individual bankers is the relative scarcity of opportunities to make loans or investments outside of the field of government and municipal securities. You are naturally concerned because of the bank earnings picture and I quite understand and sympathize with your viewpoint. We must realize, first of all, that banks today are living in a very different period from that of the twenties. Then they had the opportunity to loan their funds readily on a profitable basis. At that time the call money market was absorbing something like

$4 billions to $5 billions of bank funds at a profitable rate of return, and these loans were looked upon as very liquid and sound. During that period we were not surfeited with billions of dollars of foreign funds also seeking an outlet in our market. At that time banks were permitted to underwrite securities and they had security affiliates. In other words, the banks then had a very much broader field for outlet of their funds than is the case today.

More than ever today the banking system should be permitted to adapt its lending policies to current borrowing needs of the community. It should not be hamstrung by archaic rules and regulations, and, as I have indicated, much has been done to remove restrictions so far as bank examination and investment policy is concerned, and through the Reserve System, under the Banking Act of 1935 and its Regulation A. The effect of these steps has been to broaden the lending field of the Reserve System to provide liquidity in case of need, so that the banks need not be restricted to super-liquid loans.

If the banks do not meet present credit needs, they will not be able to survive; the public is likely to demand and Congress to enact legislation setting up government agencies that will meet the needs. And that, in turn, apart from the competition, puts added burdens upon the Government. So far as I am concerned, I want to see those burdens lightened by releasing private energies and so far as possible by utilizing existing private instrumentalities essential to the economic system.

It is not realistic, it seems to me, for us to complain because interest rates are low. We must learn to recognize the close interrelationship of all of the factors in the picture and realize that the solution of the individual bank's problem lies, as it does with industry, not in distributing a small amount of its product at a high rate, but in expanding the market so that the returns, even at low rates, will exceed what would be earned by the marketing of a restricted high-priced product. Similarly, as to taxation, our views are likely to be somewhat narrow. What we are interested in, as I see it, is not so much tax rates by themselves. What we really are concerned about is how much we have left over after we pay the taxes.

We would do well to ponder the fact that taxation in the United States--that is, all taxation, national and local combined--for the past three years has averaged around 17½ per cent of the national income, whereas in Great Britain all taxation has averaged around 20 per cent in the same period. But here is the difference: Our national income during this period has been averaging only about 75 per cent of the 1929 national income, whereas in Great Britain the national income has averaged around 110 per cent of the 1929 level, and last year was about 118 per cent of the 1929 level. In other words, while the tax rate is higher in Great Britain, it is applied on a relatively much higher national income so that what is left over after paying the higher tax rates is comparatively larger. To put it another way, if we assume that our national income averaged $88 billions, which would be a comparable

percentage with Great Britain, and that our tax ratio were 20 per cent, as it is in Great Britain--or higher than our tax ratio is now--we would be collecting nearly $18 billions a year in taxes, which would be between seven and eight billions more than we are collecting now. This, of course, would more than take care of all deficits and leave a substantial surplus. Even after paying this higher tax rate, we would have $70 billions of national income left over, whereas before paying any taxes, our national income has averaged roughly $60 billions in the three years referred to, or approximately $50 billions net after paying the taxes. This, you will note, is $20 billions less than would be the case if we paid the higher taxes of $18 billions but paid them out of a high national income of $88 billions.

Does this not demonstrate that a high tax rate does not necessarily impoverish a nation, and that the real point is not the rate but how much is left after paying taxes? And, above all, does it not indicate why our major objective must be to reach a maximum of production and employment which are synonymous with an increased national income? That, as I see it, is the one sure way and the only way in which we can achieve the balanced budgets which we all wish to achieve. Does it not indicate, also, that to attempt to cut down expenditure, whether private or public, before we have reached a national income reflecting reasonably full use of our man power and productive facilities, would be a very shortsighted repetition of a mistake which has been made before?

It seems to me that all of us, and particularly those of you who now occupy or will in due course occupy positions of responsibility in the banking world, must look at these fundamental problems from a far broader standpoint than has been typical of most of us in the past.

Speaking as one who spent twenty years as a banker before coming to Washington, I feel that the bankers should realize clearly the part that the banking system as a whole plays in creating and maintaining conditions conducive to production and full employment--the ultimate end and aim justifying the existence of our economic system, and that we should lend support to policies designed to call forth a maximum of production and therefore of employment under the incentive of the profit motive--the mainspring of our system. We must learn to distinguish clearly between measures that encourage and those that discourage private activity, private investment and risk-taking, for manifestly only as private activity thrives can the Government's burden of caring for those in economic distress be reduced. We have much to learn, but we can approach sympathetically the problems of so shaping monetary, fiscal and taxing policy as to create a climate in which private enterprise may have full play to enrich human existence even beyond the great contributions it has been able to make in the past. These problems are essentially economic and not political.

No central banking policy, nothing that the banking system of itself can do, can provide an adequate productive use of created funds. It is, therefore, necessary for us to recognize that outside the banking field itself there are heavy responsibilities upon any government in a democracy to adapt other policies to the revival and maintenance of private activity at the highest possible level. It is clear from past experience that when national income begins to

decline rapidly, when unemployment begins to develop on a large scale, from whatever cause, no government in a democracy has any choice except to try to arrest the cumulative deflationary forces. We cannot expect private capital to employ people when they cannot be profitably employed because there is no demand for their products. We cannot expect private capital to expand facilities and thus give employment when excess capacity is developing as it is bound to do as deflation sets in. Positive action by the Government is essential at such a time to increase consumer buying power and to provide the employment that otherwise would not be provided. To this end, the Government, through its borrowing power, must temporarily take over and put into action the otherwise idle funds of investors, and when, as happened after 1929, there is a vast shrinkage in the volume of bank money, it must create new money by the sale of securities to the banking system and put this newly-created money to productive use.

When deflation has been arrested, we must adapt policy to sustaining an orderly recovery, avoiding the pitfalls recently experienced as a result of excessive inventory accumulation and excessive extension of consumer credit in relation to net income, of inadequate capital expenditures in such basic industries as railroads, housing and utilities, and of wrong timing of public with private expenditure in 1936 and the Government's too sharp withdrawal of funds from the spending stream in 1937. We must better understand the bad effects of unbalanced price conditions, whether resulting from ill-advised price, wage and hour

policies by labor and industry or from other causes, such as a failure to sustain agricultural income. We must recognize that taxation policy should be closely integrated with monetary and fiscal policy--that taxation is not a separate matter concerned only with the raising of revenue, but that the type, the timing and effect of taxation upon the stimulation of private enterprise or upon restraint if a speculative boom threatens must be considered. In the past we have applied taxation policy with perverse effects upon the economy, by trying to increase or at least failing to decrease taxation in depression when the burden becomes insupportable, and by reducing taxes in boom times when we should retain or increase taxes as a means of needed restraint.

We need to recognize that the principle of a flexible budget is a necessary safeguard of private capitalism, and we must learn to use it as one instrumentality for moderating economic extremes of inflation or deflation. Once the principle is understood--though I recognize that this is a very complex problem--it may be that tax policy will prove a useful aid not only as a stabilizing influence, but as a mechanism for timing and directing a flow of funds in the economy as a whole, so that tendencies towards accumulation of idle funds may be offset, or conversely, when there is need for more capital accumulation, it can be stimulated. In other words, it seems to me that we may well consider the influence that tax policy may have in contributing to a well balanced relationship between consumer buying power on the one hand and savings and investment on the other hand. Such a balanced relationship is essential if we are to maintain reasonably full employment

which, in turn, is a necessary condition not only for the protection of existing values of loans, investments and other forms of capital, but also to provide further opportunities for profitable investment of new savings.

I have only touched upon some of these larger questions, which I know to be complex and controversial, but which seem to me to be inseparably interrelated. I have sought to suggest a general approach which I feel the bankers, especially the younger men in the profession, might well consider if they clearly recognize the public responsibility that rests upon the banking system. Once that responsibility is recognized, it seems to me that they should be willing to adapt banking policy and banking machinery, including the present badly coordinated banking structure, to present day national needs. They should be willing to approach sympathetically questions of government policy, closely related to banking policy, and directed to the same ultimate goal of giving the fullest possible expression to and thus preserving a capitalistic democracy.

Capitalistic democracy has more than justified itself in the past. There is no reason, except our own failure to understand the nature of our economy, why it cannot achieve even greater results in the future.