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BY

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It is particularly gratifying to me to be on the same program with such distinguished speakers as Sir Arthur Salter and Dr. James, for it so happens that the two books which made the deepest impression on me in the depths of the depression nearly a decade ago came from their respective pens. When I pleaded my inability to measure up to the high oratorical standards of such eminent economists and authors, the arrangers of your program intimated that they wanted me for contrast. As I recall, Dr. Jordan, in introducing me a year ago, said that I had the habit of saying the things you did not like to hear. If I succeed in living up to that dubious reputation, I can lay some of the blame at the door of Sir Arthur's "Recovery--The Second Effort" and to Dr. James' "The Road to Revival". Those volumes have been in my office ever since I have been in Washington, and in glancing back at them a few days ago, I noted again passages which I had marked nearly ten years ago -- what I think were prophetic words.

For instance, Sir Arthur wrote: "The role of finance is to be the handmaid and servant of economic activity", and in recording "The Passing of Laissez-faire", he visualized the development of a "system in which competition and individual enterprise on the one hand and regulation and general planning on the other will be so adjusted that the abuses of each will be avoided and the benefits of each retained."

And I noted again in Dr. James' book his remark that "the final aim of economic activity is the enriching of human life", and his statement that our industrial potentialities make it "possible, by the redistribution of national income on a sounder social basis, to offer to the average man

"and woman a standard of living more worthy of economic civilization."

I apologize to the authors for snatching these too brief random statements from their context -- yet they serve to point up what I wish to say. During the intervening years the democracies have been moving (slowly but, I think, surely) along these paths, seeking to realize these objectives.

In a recent issue of The Economist, of London, I noted the statement that the end of the gold standard also marked "the end of the Financial Age, the failure of the last attempt to restore the dominance of finance over economics." And the article added: "The foundations of a new order of ideas have been laid in the ensuing years, in Britain, in America and in Germany, and the war will carry the process much further. The world is showing an unmistakeable tendency to argue that, if a thing is physically possible, whether it be fighting a war, or removing unemployment, it must not be stopped by considerations of 'sound finance' alone. In war, finance is manifestly a mere camp follower, and the tendency is to reduce it to dependent status in peace as well."

Sir Arthur's relegation of finance to the role of "handmaid and servant" and not the master of our destinies is echoed in this comment ten years later from The Economist. Dr. James' vision of the "redistribution of national income on a sounder social basis" is today, even in a world at war, much more of a reality, as evidenced by the trend of social legislation in the democracies and the shaping of fiscal, monetary and other public policies toward a wider, more equitable distribution of national income. We propose to save democracy, as we say, but not to repeat the economic mistakes that lie at the bottom of so much of the world's disorder. We

propose to preserve democracy as the hope of civilized peoples to achieve the economic progress that the machine age makes possible. The tragedy is that the world has turned the machine to producing for war instead of for peace. Engulfed in the tide of human madness, we have no choice but to arm. Yet we may well take thought now of the kind of peace we mean to have on earth and the use to which we may turn our industrial and technological might when once we are free again to move on toward the goal of "enriching human life."

My own economic philosophy, if I may call it that, is based on the conviction that, if we have the understanding and the will, we can make our capitalistic democracy produce as fully for peace as for war times -- with vastly fewer complications and enormously greater benefits for the human race.

The experience of the last eight or ten years and even of the present points the way to combine intelligent government regulation and planning with freedom of private enterprise and competition. It can be done without regimentation and without abandonment of representative government, though I agree that it calls for adaptation of our political processes so that there may be far more foresight, far better direction and timing in public policy than has been the case in bygone eras. One does not have to be an easy optimist to believe that a far greater, a much more widespread and enduring prosperity -- "a standard of living more worthy of economic civilization" -- will result.

While we cannot hope to realize these high aspirations in a world at war, they need to be kept in view as the ultimate goal and vindication

of the system we mean to defend and preserve. And with these objectives in mind we can perhaps better judge whether changes which have already taken place in our economic processes are improvements and not the evils that they may first appear to be.

Not the least significant change is the subordinated role of finance in the world today. Central banks, for example, are no longer the creatures of powerful private groups. They have everywhere become more and more the servants of government.

Where the color of independence still remains, it is largely a fiction. The interest rate is determined, whether admittedly or not, by governments, not by banking or finance. In Great Britain, and in Canada, and to a lesser extent in our own country, the government has, in effect, asserted its sovereign power over the supply and the cost of money. Governments no longer deal at arms length with the financial world. They are no longer obliged to finance at the high rates that prevailed in the last war. Government action and policy are responsible for the rate structure, and with the assumption of this responsibility governments no longer think merely in terms of how good a bargain they can drive in the financial markets, but larger considerations of public policy have to be taken into account. In Great Britain, in Canada, the primary consideration is not how cheaply the war effort can be financed, but whether the rate structure is so adapted as to utilize most effectively the existing money supply and whether the rates are such as will permit the private credit system to continue its function on an effective basis.

It is highly commendable, in my opinion, that these are some of the considerations which our own government has been weighing in its financing

operations. Extremists in all countries will not agree, of course. On the one side are the groups that clamor for the issuance of non-interest bearing government securities. While professing to be in favor of preserving capitalism and democratic processes, nevertheless, they would strike at the heart of both by destroying the private credit mechanism. On the other side are the old-line conservatives who measure all things by the departed gold standard. Despite the evidence in the late 20's of the ineffectiveness of high interest rates in preventing or even restraining speculative excesses, despite the record since then that low rates are not by themselves sufficient to bring about recovery, they cling to the belief that inflation can be curbed or deflation remedied by the simple device of the interest rate. It is highly unfortunate that orderly economic progress cannot be arranged that easily. However, I cannot view with alarm the trend throughout the world to discard such a fallacy.

The assumption by governments of responsibility for the supply and cost of money has greatly altered the role of central banking operations. Not only must central banking authorities work in close cooperation with those responsible for government fiscal and financial policies, but they must be prepared to use central banking powers to support and sustain those policies, once they are formulated by the government. Nor do I view this as a backward step. It seems to me to be wholly in accord with democratic principles that elected governments shall have command over the most important functions essential for successful administration. It can hardly be denied that control of the supply and cost of money is one of the most vital of all functions. Those of your generation and mine are hardly in a position to

argue that governments will be less enlightened, less capable of successful and proper management of this function than private interests have been. And there is always the redress in a democracy of supplanting any government that misuses or abuses such vital powers.

But beyond this trend -- the subordination of finance to economics -- it seems to me to be significant and fortunate for democracy that the new emphasis is on production. It is, of course, tragic that the world thus far can only gear itself to full utilization of its man power and material resources in the making of war or the implements of war. It will be a world tragedy if, when peace is restored, we revert to the doctrine that we cannot afford to employ our human and material resources in full production.

Yet there will be such a reversion unless we prepare now to make the transition back to peace -- unless we plan to keep the emphasis upon full production -- the maximum that can be called forth by private enterprise and initiative, but with government prepared to assure useful employment to all who are able and willing to work who cannot find jobs in private activity. Again, I think it significant and fortunate for democracy that the most important political leaders of all parties agree upon that fundamental, however much they may disagree about how to apply it. I cannot view with alarm the trend throughout the world toward engineering rather than finance economics as a means to full production. The defeatists are those who say it can't be done -- that we can't afford it, that democracy can't achieve it. If that were so, then democracy could not and would not deserve to survive. Surely we are not saving democracy from destruction by war to have it destroy itself in the aftermath.

Production is the keynote of economics of peace as well as of war. We do not ask today whether we can afford full production. We are prepared to make every sacrifice to obtain it. Unhappily, as I have said, it is production for destructive, not constructive, things, and it is of necessity concentrated upon the industrial sectors of the economy. Our economic problems are not only those of the inflationary side of the cycle, but they are tremendously complicated because we must turn out more and more of the implements of war and less and less for civilian consumption. In peace times there would be no such complications.

Since I spoke here a year ago we have witnessed the gradual evolution of our national policy toward what, in the words of the President, has now become an "unlimited commitment" on the part of the American people that there shall be a free world. In that period we have taken the first steps in the program of all-out production that is necessary to implement that policy. Our effort thus far has been carried on in an economic atmosphere which was favorable to the expansion of both military and civilian output, and, for this reason, the public is as yet inadequately prepared for the sacrifices that must be faced if the defense effort is to be carried to a successful conclusion. While defense expenditures have risen in the past year from 300 million dollars to 1,500 million dollars a month, national income expanded to an annual rate not far from 100 billion dollars a year and industrial production has increased by about a third.

As long as defense production could be increased without diminishing civilian output, little if any sacrifice was required. It is true that taxes have been increased and also that we have had to pay the comparatively

small penalty of 10 per cent increase in the cost of living. But even with these offsets, our population in the aggregate has seen better times than ever before due to greater production, wages and employment. The ironic fact is that until now the defense effort has been a blood transfusion for civilian welfare.

We seem clearly to be at the end of the rising curve of civilian output. Although we have not yet exhausted our resources of unused labor and industrial capacity in some categories, we have drawn heavily upon them. The defense program has expanded in total volume far beyond what anyone envisaged a year ago. It is still impossible to foresee its total cost or to estimate what proportion of our national income it will require at its peak. At the moment, its total cost is scheduled at almost 70 billion dollars. Defense expenditures are currently absorbing about 18 per cent of our national income. While these expenditures have almost doubled since last June, there has been comparatively little change in the physical volume of production, a fact which, while attributable in part to temporary circumstances, suggests that it will be increasingly difficult to maintain the rapid rate of increase in output that characterized the period up to last June.

In the light of these circumstances it is unlikely that in the future the full requirements of the defense program can be met by drawing unutilized reserves into the productive process. Resources now devoted to the production of goods and civilian supplies must inevitably be curtailed. I am speaking not only of consumer requirements but also plant, equipment, and other capital goods available to replace and to expand productive capacity outside the defense industries themselves.

What I have just said refers, of course, only to the over-all total of goods for civilian use. There are many items like foodstuffs, various non-durable goods, entertainment and other services which the public can buy in increased volume without using resources needed for defense, but the expansion in these sectors will be balanced and doubtless overbalanced by the contraction in the production of durable goods using scarce raw materials, machine tools and skilled labor.

The basic problem is manifestly a physical one. It is one of production -- not of finance. Insofar as it is possible, the expansion of output is the answer to our major difficulties. I believe that our people as a whole confronted with the choice between consuming less or working harder would prefer to minimize the sacrifice of living standards by doing more work. In terms of the present economic situation this means longer hours of work, maximum utilization of equipment by working as many shifts a day as technical considerations will allow, and abandonment of output-restricting practice. It means drawing surplus agricultural labor from farms into factories and it means an increasing number of women going from household work to commercial and industrial employment. It means emphasis on industrial training programs and the removal of discrimination against hiring the aged and other groups able to make a contribution to the nation's productive effort.

But with all these extensions of effort we shall not be able to avoid a temporary reduction in the standard of life if we are to devote our productive resources to defense to the extent already planned. The reduction we should permit needs definition. On the one hand, there are many Americans

whose scale of living is so irreducibly low that no sacrifice can be demanded in that quarter. Above this level reductions must be allocated to all groups. The generally required reduction should be shared on an equitable basis. This means that sacrifices will have to be distributed all along the line in the lower middle brackets, the upper brackets and in the corporate tax structure. We should reach a condition where no one is able to talk piously about sacrifices when he is making none himself and is really referring to the sacrifices of the other fellow.

Meanwhile, government net expenditures will continue to rise. Aggregate money incomes will continue to increase. In the absence of special restraints the people receiving these increased incomes will seek to spend them. The prospect of an increasing flow of money and of a diminishing volume of goods available for the civilian market inevitably spells one thing of which we have heard a great deal since I met with you a year ago -- inflation. While it is conceivable that a very large and complex enforcement machinery, backed by rigorous penalties, might be able to hold prices steady in the face of the mounting pressure of demand, the task will be made infinitely easier to the extent that the growth of demand is held in check by taxation and by other functional as well as selective restraints upon the flow of incomes and the expansion of credit.

Of all the available restraints taxation is at once the most effective and most equitable. Since the middle of 1940 we have passed three major revenue acts, representing in the aggregate well over 5 billion dollars per annum of additional revenue. Measured by past standards, that is a very large tax program and one that has sharply increased the levies upon many

groups of taxpayers. The normal rate of corporate income tax has been increased by about a third and a new surtax has been imposed making the total rate of tax payable in corporate income in general about 63 per cent higher than it was in 1939. We have taken the first steps in the direction of effective taxation of excess profits. We have measurably increased some of our excise taxes. Rates have been increased and exemptions have been lowered under the individual income tax. As a result of these changes and the rising level of business activity, tax collections can be expected to be about 6 billion dollars greater in the calendar year 1942 than in the current year.

The tax structure as it now stands will be an important restraint upon the growth of private expenditures. In addition, of course, other restraints have been or will be applied in the form of direct price controls, priorities and allocations that promote defense but curb civilian production in housing and other durable goods, regulation of instalment credit, and the proposed increase in social security taxes. While it is impossible to estimate how far such measures will go in preventing demand from outrunning civilian supply, we know that by the middle of next year defense expenditures will probably be running at an annual rate of somewhat more than 15 billion dollars above the middle of the current year. The conclusion is inescapable, therefore, that additional taxation must be imposed and further restraints applied.

So far as further taxation is concerned, I hope that it will first tap the corporate excess profits and the middle and upper individual income brackets and close numerous conspicuous loopholes in the corporation, individual income, inheritance and gift tax structures. At the same time it

is important that Congress enact an effective price control measure and that some curbs be applied to repeated demands for wage and salary increases, as well as to agricultural prices. Beyond all this, however, I believe it will be necessary ultimately to adopt measures that will tap all incomes, dividends and other such payments at the source, possibly in the form of the so-called withholding tax or such a tax in combination with an enforced diversion of such income payments into government savings bonds redeemable after the emergency is over.

From the standpoint of public morale, it is essential that the long purses be tapped first and heaviest in accordance with the equitable principle of capacity to pay, and that there be no attempt to shift the tax burden to the lowest income groups whose standard of living is already down to or under reasonable subsistence levels. Only when those at the top of the income scale, who have the most at stake and who do not have to make real sacrifices in their supply of food and other necessities, have been made to bear their full share of the tax load can reaching into the shorter purses of those who have the least at stake be justified.

The timing as well as the nature of all measures of restraint is of great importance. Public morale is as vital to defense as the implements of defense. The government has to take account of mass psychology, of the fact that the public is not yet fully awake to the gravity of the international situation and the sacrifices that must be made. So far as the economic front is concerned, our people have the choice either of paying taxes, subscribing to savings bonds and cooperating in other measures to curb price inflation, or of seeing the buying power of their money progressively shrink. The former is the only intelligent choice for anyone who even re-

motely understands the evil consequences, now and in the future, of inflation.

I think the situation was admirably summed up in the recent report which the Emergency Board, appointed in September under Section 10 of the Railway Labor Act, made to the President. "The huge incomes disbursed by both defense and civilian industries," said the report, "magnify the demand for civilian goods. But the output of civilian goods is not likely to expand significantly, if it expands at all, in the months ahead. This condition alone sets the stage for a dangerous inflation, and the process is being activated by wage adjustments to rising living costs and price adjustments to rising wages -- the familiar vicious circle. . . . No group has more to lose from inflation than the nation's wage earners. To save this nation from the blight and chaos of inflation it will probably be necessary to impose drastic new taxes on the public as a whole, immobilize a part of the expanding purchasing power by some organized scheme of savings and, most important of all, adopt a comprehensive plan in regard to wages, profits, and the prices of both agricultural and industrial commodities."

The government, as the report said, is cognizant of the problem, and the government alone is able to make a well formulated and coordinated attack upon the problem. It is fair to say, I think, that the government today shows a far greater awareness and understanding of the problem and a far greater determination to deal with it effectively than was the case in the last war. And this is attributable partly, at any rate, to that trend I spoke of at the outset -- the increasing assumption by government of responsibility for economic welfare. With that responsibility goes the obligation to act wisely, fairly, in the interest of the nation as a whole

and not in the interest of any group, class or section of the country.

The prophets of disaster we always have with us. And they would have us believe that the only alternatives to a laissez-faire, gold standard world are dictatorships and an end of our economic system. I see no such portents of evil in the broad trends in democratic countries toward responsibility for economic welfare. And, as a banker, I recognize that this involves government command over the creation, cost and flow of money in the economy. To my way of thinking, these changes are not the forerunners of dictators or other disasters. They are necessary steps in the adaptation of our political and economic processes to meet the challenge of a new day.