

7/2/48

Dear Mr. Eccles:

I was the reporter at the Utah Bankers Convention, at which you gave that outstanding address. It must have been gratifying to you to have such a large, attentive and appreciative audience.

Realizing the importance of your message, Mr. Eccles, I am taking the liberty of enclosing a rough draft, which I should very much appreciate having you edit, making any corrections and/or clarifications you may desire, as I am more than anxious that my report for the Association may be complete and accurate.

Please accept my thanks in advance for this favor, and best wishes for your continued success.

Respectfully yours,


(Mrs.) Emma A. Nash

Please return corrected ms. to
Mrs. Emma A. Nash
1007 South 3d East
Salt Lake City 4, Utah

A D D R E S S

(Would you care to suggest a title?)

by
MR. MARRINER S. ECCLES
Member
FEDERAL RESERVE BOARD
Washington, D. C.

My friend Charley, President Dyreng, Ladies, Fellow Bankers, you have been good enough to invite me to attend the Utah State Bankers meeting as a speaker I think every year over the past 14 years while I have been away from here, and I have felt that it was impossible for me to be present until this particular time. Congress was usually in session, and as long as I was the Chairman of the Federal Reserve ~~Board~~ ^{Board} ~~Bank~~ I found it difficult to get away. This year with Congress out of session and with a changed status I found it easier to accept your invitation, and I can assure you that I do not know of an invitation that I would prefer accepting to the invitation of this Association, being, as Charley has said a product of Utah, and having at one time been President of this Association, I think it was in 1924. For you who do not remember that long ago I will remind you that I had the distinct honor to be President of the Utah State Bankers Association, so after a period of 24 years it gives me pleasure to address you today.

As you all know, I was put somewhat (I have related this before) in the position that Lord ~~Cains~~ ^{Keynes} (?) stated of Lord ~~Cato~~ ^{Catto} (?), the Governor of the Bank of England. When the labor ~~power~~ ^{Party} went into power in England, Lord ~~Cato~~ ^{Catto} said to Lord ~~Cains~~ ^{Keynes}, "Now that labor has ~~gone~~ ^{come} into power I suppose they will chop my head off." Lord ~~Cains~~ ^{Keynes} said to him, "Yes, they will chop your head off, but they will put it back on with a tilt to the left." (Laughter)

I am ~~sure~~ not sure whether I am in a more or a less fortunate position than Lord ~~Cato~~ ^{Catto}. They did cut his head off, and I suppose put it on with a tilt to the left. Mine was not entirely severed; just, I suppose, left dangling, and as to the tilt, I feel pretty sure that neither this nor any other administration would have very much influence in changing the tilt. Over a long period of years I have at least felt that I knew the tilt that it should bear. There are times, I think,

when our economic and social trends might veer too far to the left and need to be brought back, and times when they veer too far to the right and need to be brought back. I try to stay on that even course so that I do not have to be tilted one way or the other. If we could keep the economy on such a course, ^{if} we ~~possibly~~ could avoid ~~the~~ booms and ~~the~~ depressions, *we would be better off.*

I have related another incident quite a number of times that I think is a pretty good story on me. My associate and assistant, Mr. Elliot Thurston, who is a very charming person and has a marvelous sense of humor, and I were together one evening and I was speaking off the record to the editors of the McGraw Hill Publishing Co. organization. They had about 50 or 60 editors and I knew a lot of those fellows, and while we were eating (before I had made my speech) I leaned over to Mr. Thurston and said, "Elliot, have I ever spoken to this group before? I seem to know quite a number of them."

And he said, "Mr. Chairman, I am quite sure you haven't, because if you had I don't think you would be here tonight." (Laughter)

So maybe if I had spoken to this group within recent years they would not have been so good as to continue to invite me every year. But be that as it may, I am glad to be here.

In reflecting upon the past, ^{we should learn} ~~and if we are going to profit~~ ^{from} ~~in the future we~~ ^{do just that.} ~~should be able to do so as a result of some consideration of our past mistakes,~~ and I must say that this generation, or at least I would say my vintage, has not a very good record of past performance. ~~I think that~~ ^{who} ~~it is pretty difficult for~~ us to say to the present younger generation ~~that~~ ^{us,} we sometimes think are becoming too radical, that they should follow ~~our~~ ^{us,} records. Our record is a record of two wars -- one was not enough -- and a record of two very serious depressions, and the way we seem to be headed at the present time would indicate that we have learned absolutely nothing from the past experience. One war, which at the time seemed to be a pretty serious one, and we spoke of it as a World War, by comparison with the second war that we have not ^{started to} ~~recovered~~ from, seems pretty insignificant.

The first depression brought the end of a good many banks in Utah and Idaho, as I recall, ~~because~~ I was at that time (in 1920 ~~when it struck~~) the President of the First National Bank of Ogden, and I well remember the deflationary pressures. However, that depression by comparison with the depression from 1929 up until 1940 when it seemed to take a military program of huge governmental expenditures to enable us to utilize our idle man power and our idle facilities, ~~we have never reached our capacity for production with 25 to 30% until we had started to wasting our manpower and our material, and that depression, of course, made the depression of the first World War seem very insignificant.~~ I am wondering if as time goes on that, based upon the past, ^{we are to have} ~~that signifies~~ bigger and better depressions in the future and bigger and better wars? It certainly seems to be the trend that we are following, but I am not going to undertake to give ^{all} the answer to the ways and means of preventing wars and depressions.

The problems I am going to discuss are extremely difficult and extremely complex. Their solution must be based upon a greater degree of enlightened self-interest than we have ever manifested. The solution is not going to be brought about by what we consider less government and more free enterprise, by less planning and more of ^{laissez} ~~laissez~~ faire. I am sure that that is not the direction ^{in which} ~~that~~ we are going, that no political change is going to change the basic economic and social direction ~~I think that~~ this country is taking. Certainly a further inflationary development, a development that is permitted to run its course, and then a liquidation that will develop as a result, is, ~~I am sure~~ not going to mean less government, irrespective of the political philosophy of any party. The great danger inherent in a further inflationary development or further expansion of credit, further creation of money, is the degree to which the government will ^{have to} intervene, and they will intervene at the request of the very people who today want the government to abdicate. ^{This will happen} ~~Certainly~~ when the process of credit deflation, which is cyclical, gets under way, ^{when} unemployment begins to mount, prices begin to collapse, and bankruptcy becomes widespread. When those conditions develop they are not self-correcting. We saw from 1929 to 1933, at the time of the bank holiday, that the further deflation went the less solvent

country became
the entire ~~column~~ of decay. I do not believe that any government will permit *the*
deflationary process to run its course to the extent that the deflation went after
and
1929. I do not think that is possible again -- I hope it isn't -- ~~but~~ in order to
prevent it the government will intervene sooner and they will intervene on an ex-
panding scale; therefore, for those of us who like to preserve as much of the free
enterprise system as possible, it behooves us to prevent, insofar as we can, *to*
~~to encourage in every way we can on the part of government a further inflationary~~
development, because I am sure that we would like to avoid insofar as possible
extensive governmental intervention. *brought about by depression.*

~~Well now,~~ *the* Speaking of what has brought us to our present impasse, primarily
it was the war. ~~It~~ *we* could not over a period of 5 years, expend over 400 billion
dollars and only pay for about 40% of that expenditure and borrow the rest of it
without creating a very substantial basis of inflation. As we know, the government
paid for about 40% of the war through taxation, and ~~they~~ *we* paid for the other 60%, a
very substantial part of it, by borrowing from the banking system, ~~altogether too~~
~~much, but~~ *was* ~~what they~~ borrowed from ~~the~~ individuals and ~~the~~ corporations was not
inflationary because that did not increase or expand the supply of money. The
supply of money was expanded only to the extent that the government's war deficit
was financed out of bank credit. I am sure we, as bankers, must know that bank
credit is the source of our money supply, that whenever a loan is made new money
comes into existence, and as a result of the expansion of credit to the government
during the war the deposits of the banking system and ~~the~~ currency in circulation
increased about 300%. The offset to that great deposit growth in the banking
system, ~~of course,~~ was government bonds held by the banks. The bond portfolio of
the banking system at one time exceeded 60% of their total deposits, whereas their
total *of* other loans and investments ~~were~~ *was* 25% and less. Now that was an expansion of
the means of payment in the hands of the public that caused the supply of goods
and services available for the public, *to be inadequate,* ~~and~~ that is what inflation is, ~~and if the~~
~~means of payment in the hands of the public exceeds the amount of goods and~~
~~services available, then, of course, you have an inflationary pressure.~~

The reason you did not have overall inflation during the war was because of a harness of control that the government imposed that made it impossible for the public to spend the money that they got ^{as a result} of the government's expenditures in order to carry on the war. That is one reason that during the war period so much of the money that the public got went into government bonds. They couldn't spend it and ^{therefore} so much of it ~~which was received by~~ on the part of corporations and individuals went into banks and became increased deposits of corporations and individuals -- idle money, a great deal of it.

When the war was over it was ~~naturally~~ ^{or} apparent, ^{it} should have been apparent to every one, that the need of controls was much greater, if anything, than during the war. ^{With the war over, there was} You had no real incentive for people to buy government securities or to save money. ^{There had been} You had accumulated during the period of the war a very huge backlog of demand on the part of not only individuals but on the part of business generally, ^{the greatest} and that backlog of demand was ^{for} something that everybody wanted all at once, and those who did not have automobiles had money or they had credit and they wanted to get cars ^{immediately}. ^{well,} the capacity for making cars of course could not be expanded quickly and it would be unwise to expand an automobile industry so that it could supply ten million cars a year for a couple of years and then what would happen to the capacity? The whole economy would be wrecked. The same thing ^{has been} was true of housing. The government did not ^{understand the real nature of} recognize the problem, ^{As a result the government} because they encouraged an easy housing credit expansion that created a demand for housing, an effective demand, ~~because the easy credit created the effective demand~~ far in excess of any possible available supply of housing. Our capacity for building housing was not substantially increased over what it was before the war, and it could not be increased readily, and yet this backlog demand was there, ^{yet} and the government immediately, under the pressure of ~~the citizens, the pressure of~~ the people of the country, took off all of the wartime controls. They took off the allocations that were in effect during the war, ^{on} scarce materials; They took off ~~the~~ building permits so that you could go out and build nearly anything. They took off wage controls. ^{These steps} ^{led to} and that naturally brought about taking off of rationing and greatly

weakened ~~the~~ export licensing so that the people from countries that had accumulated dollars during the war came in and paid all kinds of prices for American goods, ~~and~~ ⁷fabulous profits were made in the ~~the~~ export business. ^{When} they finally took off ~~the~~ rationing ~~and~~ all that was left on was price control. Well, price control without the harness of other controls was ~~absolutely~~ ^{About} worthless, ~~because~~ all it did ^{to} was encourage black markets. The price control instrument was dead six months before it was repealed, ~~and I was one that~~ strongly advocated ~~the~~ repeal of price control after other controls were taken off.

Another thing that was taken off was excess profits taxes. They put excess profit taxes on during the war to prevent war profits. The real war profits are the profits that have been made since the war. The profits that have been made since the war have been fantastic, as you all know if you are following the reports of business profits. Now those profits are a result of the war and they are just as much war profits as if they were made during the war. The fact that they were not made out of orders that came directly from the government does not mean that they were not just as much war profits, ~~because certainly when~~ ^{necessarily} the government deprived the public of ~~the use of~~ automobiles or housing all during the war period, ^{At the same time, the government created} and then in the process it provided the purchasing power for the public ~~seems to~~ buy housing and automobiles immediately after the war, ^{That purchasing power} ~~was~~ ^{therefore} certainly all profits ~~were~~ a direct result of the war and were war profits, ^{and certainly} you couldn't think of avoiding the first and ~~the~~ second and third round of wages without an excess profits tax in effect. ~~So that fuss about the first, second and third round of wages~~ and when we see the ceilings taken off of food and agricultural products, we see no excess profits tax on ^{the net result is that you have had far} ~~more~~ more inflation since 1945 up to date than ~~we~~ had from 1940 to the end of the war. The real inflation was not from 1940 to 1945, ⁷the real inflation has come within the past two years with the taking off of all of the controls prematurely.

all the essential harnesses put on to it

Now this large supply of money that was created during the war and the ease with which further bank credit could be provided ^{were} ~~was~~ very potent further inflationary force. The banks have done their share to help bring about the present

inflationary development, and to that extent the law of compensation will see to it that they pay the price. You always pay the price sometime or other. ~~The banks have done their share.~~

~~Since the war~~
The only important anti-inflationary force that we have had in the economy has been the Federal budget; ~~The government since the war ended has collected from the public in taxes, and this includes social security taxes, in excess of government expenditures, 14 billion 300 million dollars.~~ ~~Whereas during the war period the government's fiscal policy created the inflationary pressures,~~ ~~since the war period the government's fiscal policy has been anti-inflationary to the extent of over 14 billion dollars.~~ ~~But~~ ~~Now during this same period of time, that the government collected from the public 14 billion dollars more money than they spent and turned back to the public, the banking system nullified and completely offset the effect of the anti-inflationary action of the government's fiscal policy. The banking system expanded an amount of bank credit and investments, other than government bonds, by an amount just about equal to what the Federal government paid off.~~ ~~The banks, in other words, created an amount of money just about as fast as what the Federal government contracted through its fiscal policy, contracted the money supply.~~ ~~Now it is true the bank deposits did not grow during this period because as the government out of their surplus that they took from the public, those deposits disappeared from the banks, the government did not ever put them back in the banks, the government used that money to retire that much of the public debt and extinguish that much of the bank asset on the one side and a bank deposit on the other, but the banks then, I say, practically offset that operation by expanding private debt, and on the asset side were private loans and investments.~~ ~~a corresponding~~

Now, you say, why didn't the Federal Reserve do something to stop this growth of bank credit? ~~After all~~ ~~this bank credit did not have any inflationary effect.~~ ~~because it was necessary in order to create production. When the supply of money in the hands of those that would spend it at the end of the war exceed ed our capacity to produce goods and services, you did not help get more production by adding more money.~~ ~~The money that was already in existence gave a normal~~

Produce more goods.
Already covered by supply

velocity the ~~velocity~~ was slow, but even a normal ~~velocity~~ was sufficient to bring about some considerable inflation without creating any more bank credit at all. The total increase in ^{industrial} production ~~was not much more than 50% over~~ ^{is not much more than 50% over} ~~Some items went up to 100% some 30%. For instance, The total expansion of food~~ ^{is} about a third. The expansion of some other items ~~was~~ ^{is} higher. But averaged ~~with~~ ^{on the} all labor ~~employed and all our productive facilities~~ ^{using} ~~are complete, our increase in physical production over 40 was about 50%, whereas our money supply was 300%. The total national product in 1940 was about 100 billion. Last year it was about 225 billion. So that the national product can still grow substantially before it overcomes the money supply without any further expansion of credit or any further creation of additional money.~~

We say that inflation is due to increased wages and increased prices. That is only part of the equation. Inflation comes ^{about} first because ~~of~~ ^{the} supply of money, ~~already in existence~~ ^{is} in excess of the supply of goods ~~that you had the inflation~~ ^{That exerts an}

^{upward pressure on prices.} ~~and you had the pressure for further inflation, and then increased wages comes about~~ ^{Then} because of an increase in the cost of living, ~~and then increased wages brought about~~ ^{in turn lead to} increased ^{a further} ~~prices, which~~ ^{This results in} a further increase in the cost of living. ~~Then in order to sustain the inflation, the banks had to expand further credit, and then profits likewise expanded. So in looking at the inflationary cycle you have to take into account not only increased wages and increased prices, but also~~ ^{the} increase in the money supply through increased bank credit, and likewise increased corporate profits. It is all part of the inflationary picture, and there isn't anyone in the group that wants anything done with ~~this~~ ^{his} particular segment. ~~Certainly~~ Labor objects strenuously to having any wage freezes or wage controls. Industry generally objects to ~~any curbing or curtailment of profits. They objected to the excess profits tax, or they don't want any curbing of profits, and certainly~~ the farmer doesn't want any ceiling on prices, but he does want a guaranteed floor over a long period of time. He wants a parity guarantee, and he ~~got~~ ^{has} it. ~~The veterans want a~~ ~~REAL ESTATE PEOPLE THAT GO ALONG WITH THEM WANT EASY CREDIT ON HOUSING WITH PRACTICALLY NO DOWN PAYMENT, and then~~ the banks want to be left free to police their

own affairs and decide whether or not they will extend ~~the~~ credit. They don't want any interference ~~whatever~~ ^{or} with any curbing of further credit expansion. And everybody wants tax reductions, ~~and that is what you get~~. Everybody got tax reductions. ~~There is no curbing whatever on expansion of bank credit, there is no curbing whatever, so that~~ All of the various pressure groups of the American public got pretty much what they wanted.

There ~~is~~ ^{are}, however, a large segment of the population, possibly 30, 40 or ~~50~~, that haven't kept up with the inflationary pressures, and ~~the~~ are ~~are~~ worse off than they were before the war. That means the old people who are depending upon pensions, ~~who are~~ depending upon savings; that means the fixed income groups who have no way of increasing or expanding their income, and that means a great many of the unorganized workers, ~~unorganized~~ ^{and} groups who have been unable to get an increased compensation in relation to the increased cost of living. So you have developing a very great disequilibrium ^{among} between the various income groups. A great many are being priced out of the market. They are ^{only} staying in through ~~the~~

^{by} using installment credit, ~~through~~ ^{and by} the using easy mortgage credit. They are thus getting some of the things that they could not otherwise get, not out of their current

income, but to the extent that ~~the~~ mortgage and credit installment credit is expanding, ^{and savings are diminishing} Even though bank credit as a whole ~~could~~ ^{very} expand little, you are ^{most} creating a difficult situation ^{is being created} for the future, ~~because just as you did in the~~ Bear in mind that in the 20's, ^{there was} no inflation in prices from 1924 to 1929, ~~and~~ ^{there was} actually had a decrease

in the cost of living of 10%. ^{There was} very little growth in bank credit. But you had a tremendous growth in ⁱⁿ loans on housing, installment credit and in ^{this stock} the ~~dis-~~ market.

^{Today} Few people got too much of the national income, and they loaned it to ^{others} ~~the~~ and when it came to the reckoning ^{the day of} ~~day~~ ^{came we} had the

depression of the 30's. What ~~is~~ going to happen when the mortgage housing credit falls off from ^{around 900 million a month} where it has been running, ~~around 900 million a month down~~ ^{perhaps} to 300 or 400 million a month? What is going to happen when installment credit, which is running at 3⁰⁰ or 400 million a month; i.e., all kinds of consumer credit, when that drops down, [?] if people today under a condition of full employment, with

~~the present high income that they got if, in order to sustain the economy, they~~
~~must go into debt on balance~~ I don't say there shouldn't be some indebtedness but
 there should not be ^a ~~any~~ substantial growth in debt on balance. Whenever debt is
 growing on balance faster than the increase in employment and production, ^{when as} ~~and you~~
~~at present we have~~ ~~aren't increasing employment because you have full employment and you can't increase~~
 production, what happens when you merely increase the ^{volume of} credit, whether it is bank
 credit or not? ^{The fact is that we could} ~~You can~~ get a substantial inflation without any further growth in
 bank credit merely by an increased velocity in the existing supply of money, ~~and~~
 during a period of inflation such as we have today we ought to have a large Federal
 budgetary surplus which is now gone and we ought to have no further growth on balance,
 or very little, certainly, in installment credit and in mortgage credit or in any
 kind of bank credit. That does not mean that you liquidate what you have, but it
 means that ^{the} growth or ~~the~~ credit extended to one group should not be greater than
 the contraction made by another group. ~~There~~ There is nothing that the Federal
 Reserve can do about this. ~~picture~~ ~~Not a thing~~ ^{why} ~~And~~ The reason ~~that~~ we cannot
 stop ~~in any way~~ the expansion of bank credit, and the reason ^{why} ~~that~~ we cannot put
 pressure on is because we cannot deny the banking system ^{access to} ~~all of the~~ reserves which
^{are} ~~is~~ the basis for ~~their~~ credit expansion. As long as ^{the banks} ~~they~~ hold a large portfolio
 of government bonds, as long as the Federal Reserve stands ^{ready} ~~there~~ as the residual
 market, as they must do, then ~~the~~ control has passed from the central bank ~~to~~
^{14,000} ~~15,000~~ private banks, ~~and they~~ ^{these banks} ~~individually~~ can elect to get ^{reserves} ~~money~~ any time they
 choose to sell their governments, ~~and~~ ^{upon} every dollar's worth of governments that
 they sell, ^{to the Federal Reserve, which is} ~~and the market, as I said,~~ the residual market is the Federal Reserve,
 that creates a reserve dollar for the banking system upon which the banking system
 as a whole ^{can} expand \$6 worth of credit or new money. So that the commercial banks,
 owning as they do today about ⁶⁵ ~~65~~ billion of government bonds, could sell six billion,
 and ~~would~~ have 60 billion left, ~~and~~ ^{upon} that six billion ~~they~~ sell, 36 billion
 dollars of credit could be ^{additional} ~~extended~~, ^{extended} ~~and that is more bank credit practically than~~
^{In other words, in this way} ~~is outstanding today. They could double~~ ^{nearly double the present}
~~outstanding volume of their loans.~~ ~~by merely selling six billion out of 66 billion of bonds. That is what the multiple~~

I discussed

credit expansion possibility is, ~~and there isn't anything in the world that the~~ *is nothing the*
Federal Reserve can do about it. That is why since 1945 the Federal Reserve has
this dilemma been pointing out to the Congress in their *Board's* reports for 1945, 1946 and 1947.

I was before the Taft Committee twice last fall, ~~then~~ *then* before the Bank and Currency
Committee of the Senate, ~~twice~~ *then before the Banking and Currency Committee of the House,*
At that time and again in April, ~~and~~ *all* pointed this whole question out. The report that I made before
those committees at that time was sent out to ~~the~~ *all* banks so I don't need to say too
much more on that subject, *The facts* but it ~~only~~ goes to show that the ~~credit~~ of the potential *credit*
which the banking system *can extend* today is almost without limit.

Now if the Federal Reserve System could use the powers that they have, which
I refer to as the traditional powers— People accuse us of ~~asking for~~ *seeking* more and
more power and centralization. People who say that don't know what they are talking
about. The Federal Reserve System, *of course,* has adequate powers to stop a further bank credit
inflation right in its tracks, but to do so we would have to ~~completely~~ withdraw
from ~~the~~ support of the government market, ~~and~~ *we* would cease to be the residual
market for ~~the~~ government bonds. Now that is what happened after the last war in
1921. They stopped ~~the~~ inflation, ~~but what did they do?~~ They raised the discount
rate, ~~they~~ denied the banks credit, and the banking system was unable to expand
credit because the ~~very~~ source of reserves on which credit was based was denied ~~to~~
them, *But* what happened to the government bond market? ~~4 1/2%~~ fully tax exempt bonds
went down to 3%. The Federal government paid 5% for 90-day paper on a fully tax
exempt basis. Now ~~that~~ *a* that is what happened. What would it be today with ~~the~~ public
debt, *This amounts to* 250 billion dollars? ~~60%~~ of the entire public and private debt combined, ~~and~~
this huge public A very large portion of ~~that~~ debt held by the banking system and the insurance com-
banks panies and the savings ~~bonds~~ *is* and the fiduciary institutions and trust funds, ~~of~~
various ~~various kinds~~ *various* that debt must be managed, and certainly the long term, the 2 1/4%
protected rate, must be ~~supported~~. You must ask yourselves what would happen to 50 some odd
billions of E, F and G bonds held by the savers of this country if the government
rate ~~were~~ *were* permitted to go up to 3, 3 1/2 *or* and 4% *with* and other rates in proportion.
Certainly the whole savings debt structure ~~that is out~~ would likely be converted.

Holders of the lower rate outstanding securities
 and they would want to go in and buy market securities, they would certainly
 want to get out, they would lose confidence in the public credit and the short term
 The government would be faced with ~~insurmountable~~ ^{its new, higher rate}
 public debt which is 13 billion dollars worth of 90-day bills that refund
 insurmountable problems in its essential refunding operation
 and there is some 20 odd billion of
 certificates and in the next five years, there is another 50 billion dollars of debt
~~that falls due~~ ^{some 76} ~~that has all got to be refunded.~~ How can that ^{debt} be refunded without
 any certain market? We just don't ^{believe} think it can, and what would happen to the banks
 if ~~the~~ government bonds were permitted to find their own level, ^{and the level, let us say,} and that happened
 to be 5 or 10 points below the present level? So you see ^{the Federal Reserve} as long as you stand
 ready to support the government bond market, ^{it} you provide money for the banks to lend.
 Under these circumstances, ^{and to raise the discount rate is meaningless.} So long as the short term rate on
 government securities is 1-1/8 ^{percent. or more} no bank is going to use the discount facilities to
 get reserves. They will sell short term government securities, ~~and~~ therefore, to
 raise the discount rate is purely academic. We have advocated that the short term
 government rate should be permitted to find its level in relation to the long term
 2 1/2% rate, but there is no point in letting the short rate go up to the point where
^{holders} they will start selling long term bonds and sell them short. The degree to which
 the short rate can go up is a ~~very~~ very small amount, maybe 1/8 or 1/4 of 1%,
 and then the discount rate can go up slightly, but that would certainly be a ~~very~~
 minor anti-inflationary measure. ^{e for} We have suggested other measures that are
 necessary and desirable, ~~not~~ as a substitution ^{of} the traditional method of raising
 the discount rate and denying the banks a market for their securities, ~~or maybe~~
 denying them credit, that is the traditional method which, as I have explained to
 you, can be used. What we are proposing is not more power, it is merely a partial
 substitution ^a for the power that has been lost and the power that it was meant that
 the central bank should have from the very inception of the institution. Today
 the Federal Reserve System is unable to perform the
 the function for which the Federal Reserve System was created, ~~no longer exists.~~
 It is an engine of inflation today. If the Federal Reserve System did not exist
 at all, ^{if it were} ~~it would be~~ completely out of the picture, you would have a ~~very~~ much less
 inflationary ^{situation} picture, because the very fact that it does exist, the very fact
 that it stands there to support the public debt is the ~~very~~ basis for ~~the~~ multiple

credit expansion. ~~Therefore~~ ^I it is important that bankers should recognize ^{this} ~~that~~ fact, ^{understand the proposals} ~~and if the suggestions~~ of the Board, ^{to deal with this problem.} ~~and they ought to know what the requirements~~ are. We certainly have no axes to grind. Our approach is ^{entirely} ~~entirely~~ objective. ^{our proposals are} ~~and if their suggestions, if that is not the way to deal~~ ^{with the problem of} ~~and influence further bank~~ credit then the banker ~~should~~ come forth with some kind of a program that will do the job in case a voluntary system of bank credit control does not work, ~~but~~ ^{the} ~~function~~ ^{to perform} ~~purposes for~~ which the central bank was created, certainly should be re-established in ^{one} ~~some~~ form or another.

Now I am not saying that ~~a~~ ^{restraint} ~~voluntary system~~ won't work, ~~I think~~ ^{at all.} I think it has done some good, but it is a pretty difficult ^{problem} ~~to~~ ^{get} ~~to~~ ^{14,000} competitive institutions, ^{to} ~~exercising~~ enough restraint and self-control to prevent a further overall credit expansion. It is a ~~very~~ ^{for the individual banker} difficult thing to deny what seems to be a perfectly sound and good loan when ~~you~~ ^{he} know if ~~you~~ ^{he doesn't} don't make it ~~your~~ ^{his} competitor will. And yet that loan creates credit, creates new money in exactly the same manner as any other kind of bank credit, whether it is good or bad, ~~and~~ ^{when} that dollar is once put out to ~~the~~ ^{the} borrower, especially if it is on a house and it isn't tied to a crop that is paid off when the crop is marketed, that dollar then becomes ^{in the spending stream} ~~gone~~ purchasing power for somebody else and somebody else and somebody else. It is ~~gone~~ when it is once created. The expansion of bank credit for housing, the expansion of bank credit for consumer credit does not increase production, ~~either~~ ^{it} ~~one of them~~ ^{or to} What ~~they~~ ^{happens,} do is increase or sustain the demand for ~~the~~ existing production. That is what ~~they~~ ^{do}. Certainly consumer credit does not create any more automobiles or any more housing. Now if you are loaning to a farmer to finish his crop and the dollar that you loan comes back to you when the crop is marketed, that is a different type of credit; or if you are loaning to a sugar company to produce a crop, ^{to} ~~or a~~ canning company, or to produce a cotton crop, and when the crop is marketed the loan is paid, then that kind of credit is self-liquidating. But most of the ~~kind of~~ ^{which} credit that the banks are ~~making~~ ^{extending} today is not of that type, ~~and there has continued to be with all~~ ^{Not with standing} the deflationary pressures ^{exerted by} ~~a heavy government tax~~ ^{collections} payment from January until March ^{amounting to} ~~which~~ was something like

7 billion dollars, ~~With all that heavy payment~~ ^{on balance} there was an expansion of credit on the part of the banking system ~~as~~ as I recall it was something like 700 million dollars. Even though there was a contraction in commercial loans there was enough expansion in mortgage credit and in consumer credit to make an overall expansion of credit during that period.

I would say to you bankers that individually you are going to have to ^{take} responsibility for what happens in your bank. There isn't anything that can be done ^{effectively} on the part of the Federal authorities to stop or to curb or to curtail or to influence your credit expansion today. There is no chance ^{for an effective} ~~thatsoever~~ for any curb on further bank credit expansion insofar as the Federal government is concerned, except persuasion; so if I were a banker I would keep my loans down so that they did not exceed, I think, about 30% of my deposits. ^{As for the} ~~The~~ government bonds that you own, that money has already been ^{created and} spent, ~~and~~ the offset to the deposits that you have against government bonds should be held against the government bonds and you should not reduce your holdings of government securities for the purpose of getting ^{more} ~~reserves~~ ^{resources} with which to expand bank credit. Now I am speaking in ~~general~~ ^{general} terms. Certainly in the consumer credit field and in the housing field I would be extremely restrictive. ~~I would~~ ^{In} the commercial lending field where the loan will be self-liquidating, where it is tied to ~~the~~ ^{so that when} production, ~~when~~ the production is sold it will liquidate the loan, ^{I would extend that kind of credit} ~~yet of course take care of that because that~~ ^{it} will help to sustain ~~the~~ production.

Now I have talked here for a long while and I have rambled around. As you know, I didn't prepare a speech but I am going to say something here that is strictly off the record. What I have said is off, too, but this in particular, ~~and it is~~ looking to the future, ^{is off the record.}

There is a great element of uncertainty. We have reduced taxes, and the budgetary surplus that we had as an anti-inflationary factor is gone. That is important. But on top of that the government has entered a program that has apparently no terminal point of expanding the military ^{establishment} ~~expansion~~ and world aid ~~expansion~~. Whereas we thought last year the budget of 37 billion was pretty

~~fantastic~~ ^{high}, this coming year the budget ^{calls for} is a minimum of 42 billions. We talk about economy in government, we talk about cutting public expenditures and we are entirely unrealistic about it, ~~or~~ ~~because~~ because the amount that can really be cut is fantastically small. So long as the military expenditure (which this coming year is 14 billion dollars) is as ~~at~~ large as it is, and so long as the foreign aid program is six billion or over, there is 20 billion in two items ²⁰ ~~so~~ long as the interest on the public debt is nearly 5½ billion, and certainly if we should do what some people ask us to do, ^{that is,} use the traditional authority of the Federal Reserve System, withdraw from the government bond market, let interest rates go up as the means of stopping credit expansion, let them go so high that people just won't borrow, or let them go so high that you certainly would ~~discourage it to the extent that you would stop inflation~~ -- where would the cost of carrying the public debt go if you pursued that policy? If you did what some of the bankers want it could be ten billion dollars. Anything that you do towards increasing the cost of carrying the public debt/even 1% on the outstanding public debt is 2½ billion a year, and if you increase the overall cost of carrying the public debt the budget would go up 2½ billion a year, so you see you can't very well cut the cost of carrying the public debt on that front.

The veterans' aid program -- and there seems ^{to be} no politician ⁱⁿ ~~from~~ ~~matter which~~ party ^{who} ^{dream} that would even ~~think~~ of not voting for practically every veterans' program that comes before him -- and you have a veterans' program of over 7 billion. You have there between 32 and 33 billion dollars in about four items!

^{the} We all want public roads, we want reclamation, and a great many people want ^a ~~a~~ farmer-aid program, they want to guarantee parity payments to farmers, and that costs another substantial amount of money; so that as you look the budget over you begin to see that so long as you have an expanding military program and an expanding foreign aid program, there isn't very much hope of further cutting the budget. There is an indication and an expectation certainly on the part of the military and certainly on the part of the people who are extreme internationalists,

that the budget by 1950 will reach at least 50 billion dollars. There is an expectation that the military program will be expanded within the next two years to 20 billion a year. Now if we have ~~on top of~~ any such ~~an~~ expansion of the military or foreign aid program and along with that you get some further inflation, then of course that means further appropriations by the government to ~~overcome~~ ^{counter-balance} the inflation. ^{Congress has} They just passed a bill that will cost a good many hundred millions to take care of Civil Service employees of the government, to give all of them ~~some~~ ³⁰⁰ odd dollars to help overcome the increase in the cost of living. ~~Now it looks to me~~ ^{app} ~~like~~ if we are going to be realistic about the future we have got to find a way of bringing about a basis for peace in the world pretty quick, ~~that~~ ^{we} we cannot carry out an expanding military program that has no terminal point, a world aid program that has no terminal point without wrecking our domestic economy ultimately on the rocks of inflation or without imposing during peace time a ~~system of a~~ harness of controls that would have to be very much more extensive than anything we ever knew during the war.

Now those seem to ~~be very difficult~~ ^{me to be the hard} alternatives with which we ~~may well be~~ ^{are} confronted. It is only natural for any bureaucracy, whether it is military or any other, or whether it is a private organization, with human nature as it is, ^{to} ~~it~~ want to get bigger and better, and certainly the Navy, Army, and Air Force ~~would~~ never try ^{ies} to find ways and means of curbing or cutting or reducing expenditures. Their attitude has always been one of finding ways and means and justification for expansion. It takes civilians to curb that kind of activity. Certainly the foreign governments, China and the rest of them, aren't going to find ways and means of reducing their demands upon ^{our} ~~the~~ government. They are going to try to find ways and means of ~~reducing their expenditures~~ justifying and getting all that they can possibly get. ^{it is} And so with the veterans and ~~and~~ with everyone else, ~~that~~ the idea of a program on the part of the military ~~with its defenses~~ that we call a defense program, or a preparedness program, seems to me to be fraught with a good deal of danger. If we had a program of preparedness for ~~an~~ offensive rather than a program for ~~a~~ ^{Purposes} defensive it would be another thing. Preparedness is a relative thing. ^{Despite} ~~For~~ ~~such~~ huge expenditure over a period of years we may find that we are less

prepared in relation to Russia than we are today. Certainly the British and the French were better prepared to deal with Hitler in '34, were fully adequate to deal with him in '35, but in '39 they were unable to deal with him. When the Japs went into ^{Manchuria} ~~Manchuria~~ and broke the Nine-Power pact we were well prepared to enforce the peace, but when they struck us at Pearl Harbor, although we were much better prepared when they struck at Pearl Harbor than when they went into ^{Manchuria} ~~Manchuria~~, relatively we were less prepared.

A preparedness program for defense, if it means anything, means an armament race, and an armament race has always ended in war, ~~and~~ ^{In} war the democracies never strike first, ~~but~~ ^{In} the next war the country that strikes first will have an advantage possibly ~~sufficiently~~ ^{attached} superior to the country, no matter what the preparedness is, when there ~~isn't~~ ^{may be no} such ~~as~~ thing as a preparedness or a defense against the atomic bomb, and those who strike first might put an end to the country they strike, and all your effort at preparedness may go to naught.

We are not living in a world or dealing with a world of ~~an~~ ^{school} old ~~type~~ military preparedness, where you have plenty of time, such as was true in the past. Nobody doubts ^{that} if we get into another war, ~~that~~ it is going to be an atomic war. It will be a war where the one that strikes first will have a very superior advantage. It seems to me that we are being confronted with the ~~unpleasant~~ ^{school} alternative of a regimentation of the domestic economy, which in itself would destroy the very thing that ^{our} ~~a~~ military preparedness is designed to save: ~~that~~ ^{or} an inflationary development ^{that} ~~beyond what we have would seem to be inevitable if we get huge~~ ~~budgetary surpluses on top of a situation where there are no surpluses and where~~ ~~there is no limit to money~~ would likewise wreck or destroy our system.

As a friend of mine said, it doesn't make much difference whether you are destroyed by your enemy or destroyed by yourself, the destruction may be just as complete either way.

~~The need at this time, While~~ we are vastly, ~~it seems to me,~~ better prepared, or could be within a very short time, than ^{any potential} ~~our~~ enemy, ^{it seems to me,} our position, should be used much more aggressively than it is in the enforcement of the peace, Even though

you risk getting into war you had better have an offensive preparedness with an end point in sight that you are prepared to carry out than a drifting program of a defensive preparedness without a terminal point. ~~Don't it~~ ^{to} You ~~had~~ better take the chance of getting the war while you are ~~xxx~~ better prepared and choosing your own time than to wait and let the other fellow choose the time while you are simply sitting by and waiting.

It is apparent, I am sure, to all of us that the United Nations has turned out ~~xxx~~ at the present time to be ~~practically~~ ^{largely} a soap box. It is ineffective. It is apparent to us that Russia is undertaking to sabotage every effort we are making in the western democracies and elsewhere in the world and is making our foreign aid program, and will continue to do so, much less effective than it otherwise may be; that it is going to be their purpose to make it essential for us to continue indefinitely, without a terminal point, a foreign aid program. If they can win by forcing us to wreck our democratic system either on the rocks of inflation or upon the rocks of a totalitarian regimentation to prevent it, that is just as effective as it would be any other way, and much cheaper for Russia.

Now we had better be pretty realistic and not shut our eyes to these unpleasant alternatives, and it seems to me that is just about what we are doing.

In getting back now to where I started, this generation of mine has made a pretty complete failure ⁱⁿ of the past. As I say, we had two world wars within the space of 25 years. One was not enough. And we had two depressions. The one of the 20's, which we thought was pretty bad, taught us nothing and we had to have the devastating one of the 30's, and it seems to me that we have learned little or nothing from the past, judging from the programs that seem to be discussed for the future.

I hate to end upon a note of what might appear to be discouragement, but certainly unless we face the realities of life, unless we cease to be Pollyannas, we have very little chance of doing any better in the future than we have done in the past.

I thank you.

(Standing applause)