

Address of Marriner S. Eccles, Member of the Board
of Governors of the Federal Reserve System, at
Luncheon of the Commonwealth Club of California,
Palace Hotel, San Francisco, Friday, April 8, 1949.

For release upon delivery,
Friday, April 8, 1949.

Democratic capitalism is in danger today first because of Russia's communist leaders and second because free enterprise nations have not yet learned how, except in war or inflation, to distribute without recurrent depressions the wealth their technological genius is capable of creating, Marriner S. Eccles, member of the Federal Reserve Board said today. He spoke at a luncheon of the Commonwealth Club of California at the Palace Hotel in San Francisco.

Discussing current and long-range problems of achieving and maintaining stable economic progress, he said that these issues "are all overshadowed and made infinitely more complex because nearly four years after the war there is as yet no peace."

Commenting on the current economic situation, Governor Eccles said: "For several months our economy has been in a phase of deflationary readjustment", and that "some readjustment is not only inevitable but desirable after such a prolonged period of inflation."

He briefly reviewed how inflation developed as a result of war financing, which created an excessive money supply relative to available goods and services. "Excess demand, at home and from abroad", he said, "inevitably spilled over into price inflation as the harness of controls, including excess profits taxes, were prematurely abandoned and as private credit expansion pumped new money freely into the already swollen spending stream."

"The resultant price dislocations and unbalanced conditions within the economy have to be corrected sooner or later", he said. "It is important", he continued, "not to dissipate our basic elements of strength and our cushions against the current recession in an attempt to shore up the economy at present inflated levels, thus perpetuating economic dislocations that developed in the inflation process. The deflationary drift of recent months has been painful to some, but beneficial to others. It was certainly unavoidable at some stage and is less onerous now than it would be if further delayed by using one costly prop after another."

"But the more important aspect of the economic problem is not the transitory one" he said. "It is the longer-range question called to mind by the astonishing ease with which our economy has met the tremendous production demands placed on it in the war and post-war period. Our remarkable achievements here, however, pose forcefully an old but unsolved problem, given conditions of peace in the world. That problem is: How can we keep our economy producing on a sustained basis at the high levels of which our manpower and productive facilities are capable? How can we provide a steady distribution of the goods and services that we are able to turn out?"

"Sustainable economic stability is the foremost long-run problem of democratic capitalism. Democracies have not yet succeeded in solving it. On the contrary, recurrent depression has been a chronic tendency of Western capitalism. And there is a tendency for depressions to become more severe."

"However small our success in maintaining stability, capitalism has succeeded in developing an unrivaled technology of production. For a

long time, except in war or general inflation, our capacity to produce has constantly exceeded our use of that capacity."

"The Employment Act of 1946", Governor Eccles said, "recognizes Government's primary responsibility to intervene and do all it can to maintain high levels of production and employment."

"Government intervention", he said, "is the only answer we have yet devised and it is likely to be the only answer to the problem of depression when it arises, because Government alone is in a position to act on a sufficient scale. I do not like this any more than you do, but it seems to be unavoidable if we are to maintain, without loss of our freedoms, the high living standards for our people which we have the capacity to produce. The experience of history plainly shows that political and other freedoms will not survive in the midst of widespread unemployment and destitution. These freedoms only thrive when there is reasonable freedom from want and insecurity."

Governor Eccles said that the problem of maintaining economic stability and providing personal and family security is immensely more complex today than it was before the first World War because the nation has become far more industrialized, urbanized and interdependent, geographical frontiers have disappeared, huge business, labor and farm organizations have sprung up with concentrated power, and the price-wage structure has become increasingly rigid.

"At present", Governor Eccles said, "democratic capitalism is drifting. Our economy is being stimulated by fortuitous developments and temporary stop-gaps. Most important of all, we are bracing up our levels

of activity by a huge military preparedness program and a large world aid program, both without foreseeable terminal points as to time or amount."

Turning to the overshadowing problem of world peace, Governor Eccles quoted Bernard M. Baruch, Winston Churchill and Maj. Gen. John R. Deane, who headed the United States military mission in Russia throughout the period of alliance with Russia, all of whom have emphasized that until the foundations for a lasting peace have been established the democracies, particularly the United States, are living under the constant threat of war and its attendant economic disorganization.

"In any realistic appraisal of the outlook today", he said, "we are bound to ask ourselves whether we are embarking on the road to peace or to war and whether we are not relatively better prepared now -- or could soon become better prepared -- to enforce a settlement than we will be five years, or ten years from now. Certainly the Soviets have not been idle since the war ended in strengthening their position -- nor will they be idle in the future. There is every indication that they are consolidating their position and mustering their strength as rapidly as they can. You can find little hope in reading history that a competitive armament race is the way to avoid war.

"But beyond all this the question is how long, to what end, and at what consequences to our economy do we follow this path? We do not have inexhaustible supplies of manpower and resources to support indefinitely, with no end point in sight, programs of the magnitude which we are now shouldering or contemplating for armament, both at home and abroad, and for other foreign aid. On the sea and in the air we are unquestionably in the same relatively dominant position today to enforce

a peace that the Allies were at the end of World War I. The democracies then could have stopped Nazi rearmament and kept the Japanese from invading the Continent of Asia. There need have been no Munich and no Pearl Harbor.

"If we look back over the chaotic interval since the end of World War II such comfort as we may derive from our success during this past year in Western Europe is more than offset by the extent to which we have been losing the cold war in the Orient. Desirable as the Atlantic Pact and the rearmament of Western Europe may be, we must not be lulled into the belief that they are final answers to the problem of lasting world peace.

"You may have seen a recent article by that prophetic exponent of air power, Major Seversky, who states that 'the indispensable condition for West European rearmament is the existence of a force capable of shielding the undertaking.' 'Invincible strategic air power', he writes, 'operating in part from the British Isles and in the main from the American Continent must therefore have number one priority in planning the economic revival and military defense of Europe.' It is his belief that such a strategic air force, whether it delivers atom bombs or any other kind of destruction, is the only deterrent that will be effective against the Soviets. 'Under present day conditions', he contends, 'huge armies and navies can hardly deter a nation whose great might is on the surface.'

"It has seemed with increasing clarity to me that the best way to avoid ultimate war, the best hope of peace in our time, is to confront the Soviets with the decisions which will lay the foundations and the conditions of a lasting peace while we have the strength to do so. If

the Kremlin is not willing to accept such a settlement, backed up by the moral force of free peoples all over the world and by countless others now enslaved, then is it not better to know it as soon as possible? Will this menacing cloud that hangs over the world grow less threatening if we procrastinate and postpone a settlement?

"All this admittedly is outside my field of monetary, banking and credit matters. Yet it is impossible to consider realistically either our short-run or long-run economic outlook without recognizing that the shadow of the Soviets looms behind every major issue. At the moment huge expenditures for military purposes and foreign aid also serve as economic props for which we have not yet developed substitutes. They waste rather than add to our national wealth and there is always the danger that we will cling to them indefinitely, not only in the hope that this is the way to peace, but also because they sustain economic activity at home.

"The challenge to democratic capitalism today comes, -- first, from its sworn enemy, and, second, from the failure to face up to the problems of how to achieve and maintain stable economic progress. We must meet these challenges, in my opinion, boldly and soon. We would do well to heed Churchill's warning when he wrote in his current memoirs:

"... We shall see how the counsels of prudence and restraint may become the prime agents of mortal danger; how the middle course adopted from desires for safety and a quiet life may be found to lead direct to the bull's-eye of disaster."