

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date October 25, 1939

To Chairman Eccles

Subject: Speech before the

From Emile Despres

National Industrial Conference Board

This is a first rough draft, with pencil
corrections. I wanted your reactions before having
it re-typed.

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I am deeply convinced that the preservation in this country of the things we value depends, above all else, upon the development by business and financial leaders of an objective and flexible outlook in dealing with their own problems. I think it particularly necessary now to emphasize the central importance of these traits, because our present system cannot, in my judgment, survive unless you who comprise this audience, and others holding similarly influential positions throughout the country, succeed in applying your native traits of objectivity and flexibility to the solution of your business problems. It is for this reason that I genuinely welcome the opportunity to speak to this group. The need for these traits has now become of critical urgency because of the extraordinary rapidity of change resulting from the outbreak of European war.

I am by no means ready to become a prophet of doom, because of my firm faith in the ultimate resiliency of our people. That resiliency is, I am convinced, strong enough to call forth in our business and financial leaders the objectivity and flexibility which have become critically necessary for the survival of our system of democracy and private ownership.

You may wonder why I emphasize the importance of objectivity and flexibility, since this has been stressed many times before. It is because I believe the whole character of early capitalist expansion

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was such as to canalize the imaginations of business men into certain prescribed channels, and to put blinders on them so far as other things were concerned; our economic difficulties since the end of the last war are, in my judgment, traceable finally to the fact that the imaginations of most business men have remained canalized in the old channels. The fixed ideas carried over from the last century have prevented all but a handful of business and financial leaders from seeing their problems in anything but traditional terms.

The hundred and fifty years preceding 1914 was a period of huge expansion. The vigorous competitiveness of many small enterprises, and the alertness of the men in charge of these enterprises to seize upon new techniques and products and explore newly opened markets, provided the instrument by which the achievements of science and exploration were transformed into spectacular economic development. Business men could well afford to concentrate on profits and be wholly sanguine about the broader implications of their policies, since their pursuit of private profit produced, under the uniquely favorable conditions of the 150 years before 1914, an expansion of the total economy of dimensions which stagger the imagination. The conditions of this period were without precedent; unless all indications since the end of the last war are to be discarded, there seems to be little prospect that they

will ever be restored in the future.

During the whole period of capitalist development from the reformation onward, the evolution of the private enterprise system went hand in hand with a parallel evolution of ideas regarding the role of the state in economic life. These ideas culminated in the nineteenth century in the familiar philosophy of laissez-faire, which, in the economic field, sought to establish that (1) any intervention by Government impeded the development of the private enterprise system, and (2) the unhindered development of that system was identical with the enhancement of human welfare. Although in the nineteenth and early twentieth centuries many of the practices of free enterprise capitalism were difficult to reconcile with a decent respect for human welfare, and although the philosophy of laissez-faire was rarely carried to the point of interfering with protective tariffs and other strategic subsidies to business itself, it was nevertheless true that the basic ideas of business men regarding the role of the state in economic life were highly appropriate to those times. Government, by playing predominantly a negative and passive role, apart from its granting of strategic subsidies, operated in conformity with the ideas urged upon it by private enterprise, and private enterprise was aided to realize its full expansive potentialities.

It is, however, the heritage of these ideas which has been the root cause of our economic difficulties since the close of the last war. The task of postwar economic reconstruction was performed through the close cooperation of Government, business and finance. The dominant idea guiding this postwar reconstruction was that we could ~~reconstruct~~ ^{recreate} the prewar world merely by wishing it into being. In the stabilization of the pound sterling in 1925, the prewar parity was chosen, not because many people actually believed that the prewar rate was appropriate to the conditions in 1925, but because the restoration of that rate was believed essential to ~~the restoration of~~ Britain's prestige, as if there were some magical property in the \$4.86 figure which would restore the British Empire to its prewar position. In the United States, the dual policy was adopted of encouraging foreign loans for the purpose of providing needed markets for our war-expanded industries, while at the same time greatly increasing our protective tariffs to assure an unmolested domestic market to other war-expanded industries. The ^{awkward} question how these loans could have been repaid was conveniently ignored and those who ~~raised this awkward question~~ ^{it} were branded as unpatriotic alarmists. Those who suggested that it would be more sensible to increase the proportion of incomes going to the consuming groups at home to obviate the need for artificial stimulation of our

foreign markets were called heretics or radicals or worse. Nevertheless, the business and financial community cooperated to expand ~~the~~ consumer buying of automobiles and other durable goods by vigorously pushing the instalment credit device, and houses were disposed of to people of moderate incomes, ~~these~~ ^{and} sales financed at exhorbitant interest rates by putting second, third and even fourth mortgages on the property. It was apparently believed that the magical operation of the financial system would make it possible to ignore ^{the underlying economic reality.} This happy illusion reached its climax in 1929 when most investors and business men induced themselves to believe that our economy's potentialities for expansion and profits ~~was~~ ^{were} not only equal to but actually exceeded ~~that~~ ^{those} of the prewar world. This was the essence of the "new era" fiction and the fantastic belief that stock prices were attaining a "permanently higher plateau." These illusions became widespread after the capacity of the financial system to bridge the gulf between the real world and the world of dreams had begun to show its first signs of wearing thin. The collapse came shortly after, when consumers had absorbed all the automobiles and houses which their incomes, supplemented by all that could be lent in instalment credits and third mortgages, permitted them to absorb; when manufacturing industry, the railroads and the utilities has fully enough up-to-date equipment to produce all

the goods and services consumers could possibly take; when individual investors, despite the skill of investment bankers in seeking to withhold unpleasant facts, began to doubt the wisdom of making further additions to their portfolios of Central European and Latin American issues; and when a more irregular tendency of stock prices reduced the transitory stimulus ^{to business} produced by the ^{individual} spending of stock market gains.

9 The tenacity which which the business and financial community clung to outworn beliefs has led many to adopt the position that these beliefs have the strength and fixity of savage taboos. An obvious implication of this position is that so long as the men clinging to these beliefs are able to exercise any significant measure of control over our economic affairs, our economy is inherently incapable of functioning satisfactorily.

Others have held that ^{the difficulty is not one of taboos but that} while ~~the search for private profits~~ ^{greatly hastened economic growth in the earlier period, the requirements} ~~of the profit system are~~ ^{the search for private is) the restoration of} incompatible with an expanding economy under the changed conditions of today.

I cannot accept either of these views. As for the first, I still have abundant faith in the ultimate ability of American business men to adapt their ideas to changing times and changing needs. On the score of intelligence we have nothing to fear. Despite ^{much} ~~favoritism~~ ^{racial} ~~social and national~~ discrimination, the individual in the United States has in general been more nearly free than in any other major

country to fulfill his own potentialities, and business has attracted a large share of the available talent. The taboos can be removed. All that is required is a refusal by business men to cling to outworn prejudices. This involves merely the development of an attitude of objectivity and flexibility in appraising the changing times.

The second ^{fallacious} view holds that there is an essential incompatibility between property interests and the interests of the public at large. This makes the mistake of assuming that business men are acting on the basis of a rational appraisal of their own interests when they act in ways which obstruct the effective operation of the economic system. This view, formerly held by left-wing radicals, is now beginning to find some acceptance among a few members of the business and financial world. These few individuals, vastly impressed by recent political transformations in foreign countries, have been won over to the fallacy that the interests of business are contrary to the interests of the public, and they have privately decided that their wealth and power can be preserved only through curtailment or abolition of democracy and individual freedom. If I shared this viewpoint I hope that, despite my own material stake in the system of private ownership, I would find myself unable to be guided by my material interests when these were basically in conflict with the interests of the vast majority of ordinary people.

I wish that those who believe that private ownership may be preserved through drastic curtailment of ~~domestic~~^{democracy} and individual freedom might have the opportunity to talk to business men and bankers in the countries where this experiment has been tried. In Germany, Italy and Japan, I am sure that the story would be ~~probably similar~~^{almost the same}; although large corporate profits have been recorded in these countries in recent years, these profits have become little more than a fictitious bookkeeping entry. Meanwhile, the whole industrial and financial system has become merely an arm of the state. While there were indications at first that the policy of the state itself was to some extent governed by the desires of business and financial groups, it is already clear that the period of ascendancy of the so-called conservative elements in these regimes was only a passing episode, a faint flicker of power before the final darkness. At the other extreme the Soviet Union, ~~while in comparison with the state of affairs in czarist days it~~^{produced a considerable improvement in} has probably ~~contributed rather substantially to the~~^{in comparison with czarist days, but it} welfare of the ordinary people, ~~it~~^{has} can scarcely be held that Russia enjoys democracy and individual freedom, as these terms ~~are~~^{have come to be} understood in the United States.

Calm appraisal of this whole range of fundamental questions leads, I am convinced, to the conclusion that the system of private ownership is indissolubly bound up with ~~democracy and individual~~^{our present notions of} freedom so that neither can long exist without the other. Our

economic difficulties do not result from any incompatibility between democracy and private ownership but, rather, reflect the tenacity of outworn ideas. I believe, moreover, that although in all human affairs the encroachment of new ideas is a gradual and painful process, outworn ideas in civilized countries do not have the tenacity of savage taboos. Finally, I believe that American business men and financial leaders, ~~despite the apparent intensity of their convictions,~~ ^{despite} their ^{is firm} adherence to traditional views, ^{(are} ^{is} on the verge of a markedly different attitude towards the role of Government in economic affairs and ^{toward} their own responsibility in contributing to the healthy development of our economic life.

This, I believe, ^(may turn out to have been) ~~has been~~ the most important contribution of the New Deal. As a result of ^(from our) ~~the~~ economic experimentation since ~~and of the conclusions which it has been possible to draw,~~ 1933, a number of individuals in public life, in the universities and within the business and financial community itself, have arrived at a correct diagnosis of the essential character of modern economic difficulty and ^{we have found to meet} ~~for~~ the ways of ~~meeting~~ these difficulties. These findings cannot be applied until the business and financial community has become fully convinced of their validity. Under our system of private ownership, Government cannot do the job without the freely given support of business and financial leaders. In the first place, under our system, policies which arouse the hostility of these powerful groups, although they may be undertaken with apparent vigour for a time, cannot be pursued with the intensity and firmness which are

essential for their success. In the second place, under a system of private ownership the role of Government is necessarily limited.

A fair degree of economic stability and a healthy economic growth cannot be attained unless ~~business men and bankers~~ ^{industrial and financial leaders} base their ~~own~~ ^{own day-to-day} decisions upon a rational ~~appraisal~~ ^(appraisal) of changing conditions. The intelligent ~~of~~ ^{for} such rational appraisal is possessed in abundance the by/business and financial community. All that is required is a genuine effort to attain an objective and not an inflexible outlook.

During the period since 1933 the business community has, to be sure, ~~is~~ shown few surface symptoms of either objectivity or flexibility. Even the most trivial of the measures taken by the Government to improve the functioning of our economic system, ~~x~~ whether the measures were well or poorly conceived, ~~have~~ ^{has} almost invariably aroused a torrent of vituperation from business and financial interests which greatly exceeded in intensity the importance of the measures themselves. The administration, faced with the apparently unalterable ~~e~~ opposition of this small but influential group, found itself alternating between mild attempts at ~~appeasement~~ appeasing business prejudices and mild attacks on these prejudices. In this respect, I believe this strategy has not been wholly ineffective because under the surface some progress has been made.

It seems to me, however, that the present testing-time for free institutions is peculiarly favorable to a change in this respect. Instead of either attacking or making concessions to business prejudices, the Government's most important job, if the institutions which we value are to be preserved, should now be one of seeking to free business from its own shackles by enabling the business and financial community to understand the origins of their misguided beliefs. I hope I am not wrong in believing that business men are ~~now~~ fully prepared to discard outworn ideas, because on it the fate of the things we value depends.

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The business developments of the past two months reveal strikingly the need for an objective and flexible attitude in the face of rapidly changing world conditions. Business expectations at the outbreak of war were based directly upon memories of the powerful inflationary stimulus exerted by the war of 1914-18. These initial expectations were little more than an uncritical projection of our last previous wartime experience. Moreover, the retrospective view of the last war seemed to be one in which the developments of those years were telescoped into a single episode. It was apparently forgotten that the increase in our exports which got under way late in 1914 was at first based in considerable part on the combination of high crop yields in this country and rather poor yields elsewhere, that industrial activity in the United States did not turn up until well into 1915, and that the upward sweep of commodity prices did not begin until late in that year. Moreover, little thought was given to the difference between conditions now and conditions during the last war. This was most spectacularly illustrated in the sugar market, where memories of wartime shortages and high prices led, despite existing large supplies, to a brief rush of buying by both professional traders and consumers.

uncritical, misguided

Largely as a result of these initial expectations, we are now in the midst of a sharp, but, I believe, temporary upward movement in industrial volumes. The avoidance of a re-

action in activity after production of goods for inventory has come to an end requires the swift emergence of less transitory types of buying. New demands can scarcely develop with sufficient rapidity to avert a business decline.

If the business community, instead of being guided by its recollections of the last war and assuming thoughtlessly that that pattern would be precisely duplicated, had sought to appraise the major elements in war demands today, the present unwholesome boomlet would not have occurred. It should have been obvious, if businessmen had given any thought to conditions today, that the stimulus of wartime orders will develop much more slowly than the business community at first expected. Has any thought been given to the very real possibility that total activity and employment, even when wartime demands have reached their peak, may remain well below prosperity levels unless business and Government act wisely? Again, have our industrial and financial leaders begun to think about the postwar danger of industrial overcapitalization and stranded workers after the war? ← (Insert)

If you believe as I do that the prospects of wise action are more favorable than they have been in the past, these questions should not be alarming. A partial reaction in business volumes following a sudden inventory spurt need not

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The present organization of industry is such that a comparatively few men in positions of leadership can exert great influence over the course of prices and orders. We no longer have a horde of small individuals each acting in isolation. The emergence of a new pattern of leadership holds great potentialities for solving many of the problems that beset us.

be a particularly frightening development. Although the present spurt in activity is based largely upon speculative and precautionary inventory accumulation, some part of the expansion in activity is a result of the recent growth in orders for capital goods, such as freight cars and industrial equipment. Activity in connection with the filling of these orders should help to cushion the early 1940 decline in industrial operations. Consequently, this decline need not degenerate into a cumulative deflationary spiral. Although Government can do a little, it is largely in the hands of business men to determine whether the reaction will be mild or severe. Will manufacturers push up their selling prices for commodities which are of strategic importance to total economic activity? Will business concerns, to compensate for their initial, exaggerated optimism, seek later to press their inventories upon a reluctant market? Will the railroads and public utilities try to anticipate their increased requirements for equipment, thereby avoiding congestion, delays in delivery, and higher costs later on? The severity of the decline in business in the early months of 1940 depends upon the answers which business men make to these questions. Will they thoughtlessly inflict unnecessary injury upon themselves and others, or will they decide to act thoughtfully and wisely? In each case the true interests of individual business concerns are, in my judgment, identical with the interests of the economy as a whole.

With respect to the longer-range prospect, we can achieve, whether or not the war continues, an adequate level of utilization of our man power, our materials, and our equipment, provided business men do not

fall into the easy fallacy that a war boom will sooner or later solve all our domestic economic difficulties, leaving no problems for them or for the Government. If they avoid this dangerous attitude, they will, I believe, refrain from putting into effect unjustified or premature price increases, and they will not be unsympathetic to a policy of taxation and public expenditure which lends support to consumer purchasing power. Finally, if the war is long drawn out, they will welcome a Government policy which seeks, through indirect restraints on undesirable price increases and through taxation of such profits as are truly excessive, to prevent an exaggerated expansion of the heavy industrial goods sector of our economy, which is otherwise likely to be most dangerously strained and distended by the localized impacts of specific war demands.