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REMARKS:

Speech of

MARRINER S. ECCLES, CHAIRMAN, BOARD OF
GOVERNORS, FEDERAL RESERVE SYSTEM

before the

CHICAGO DISTRICT
ILLINOIS BANKERS ASSOCIATION

October 15, 1941

Fraser

It is not often that I speak in public because of the public position I occupy, without careful preparation before hand of what I desire to say, I know that the press is here tonight, and I am going to make an exception and talk on the record and not off the record, and I only hope they will continue to treat me as kindly as they usually do. *except off the record*

I do not believe I have appeared before a group of bankers since I have been talking about the dangers of inflation and suggesting some of the ways with which the problem might be dealt.

I am probably better known to you and the country at large as a very unorthodox person, as one who believed in government intervention, one who believed in spending, one who believed in very low interest rates, one who believed in the stimulating and expanding in every way possible of credit... both private and public. Some of the people who have not followed me very closely have not understood the fundamental philosophy I have believed in, namely, that of compensatory economy, wherein the government uses its influence in times of deflation to stop deflation, and likewise wherein the government uses its influence in times of inflation to stop inflation. I, therefore, have been accused recently of coming to my senses and seeing the error of my ways, of getting religion.

I haven't changed a particle in my fundamental economic philosophy. It is the conditions that have changed. I don't believe that a man should wear the same kind of a suit of clothes on a hot summer day that he should wear in the dead of winter. Neither do I think that the same economic approach should

be made to the problem of deflation that ^{is} ~~are~~ made to the problems of inflation. I do not think that there is any more justification for government intervention to stop, control, or retard inflationary developments than there is for government ~~intervention~~ ^{t. see} ~~in dealing~~ with the problems of deflation. These problems of deflation can be just as serious for the debtor as inflation is for the creditor. Both are destructive to our economy. Both result in hardship...real hardship to the great masses of our population.

It has always seemed to me that our man power, our raw materials, and our productive facilities constituted our real wealth; ^{that} Our money, our credit system, and our fiscal policies were all merely instruments that could and should be used to produce and to distribute a maximum amount of the things that the people of this country have always needed and wanted. If this could be done, then democracy would never stand in jeopardy.

The only reason that we have wars and revolutions in this world is because of man's inhumanity to man, because of our complete failure ~~to be able~~ through our political and economic system to produce and distribute what we have the capacity to produce and to distribute. Back of my thinking there has always been the concept of what is real wealth and how ^{do we} ~~do we~~ use the political, economic, and financial mechanism to produce and to distribute it.

The only loss that the economy as a whole can have is the loss of idle men, idle factories, or the loss through destruction by war...also the loss, through being forced in the kind of a world we live in today, to divert our man power and our productive facilities to produce things of war rather than the things of peace.

In the early 1930's, we found that it was necessary for the government to intervene, although ^{it} they adopted an uncertain and halting policy. We were confronted with new economic problems due to the fact that we had become a great creditor nation. There had been great advances in technological developments, great advances in mass production. We had no blue prints or charts for a new course to meet the far-reaching problems of deflation.

Everything that ^{was} done, and I think most of the things that have been done even more recently, particularly in the field of government fiscal and monetary policy, were thought of as emergency measures rather than as part of a necessary planned program to make the economic system function.

It was necessary to create an easy money policy in order to stop deflation or at least to create a climate favorable to expansion. The interest rate that bankers so often think and talk about is not a ^{natural} material thing. It is just as artificial as the money system itself.

The fact that money was so easy in the early 30's was not due to the fact that there was a lack of demand or that the supply was ^{not} ~~inadequate~~ or could be made ^{still} more adequate. Some people think that the supply of money is somewhat of a stagnant thing. It isn't, of course, stagnant at all.

Throughout the deflation from 1929-1933, the supply of money, which is bank credit, was greatly diminished through the liquidation of bank loans and investments. To take the pressure off of liquidation, the Federal Reserve System carried on open market operations. They made it possible for the banks to ^{carry on} get loans and still have excess balances in the Federal Reserve System. The discount rate was dropped and pressure for liquidation was greatly reduced, but that did not bring recovery.

It was necessary for the government through its credit agencies in the field of homes and farms to take over a lot of loans from our institutions, to refinance them and reduce the rates. This easy money was not a natural development, it was an artificial thing. The whole policy of the government in this respect added greatly to the deposits of the banks on one side of the ledger and to the excess reserves on the other side.

The action of the Board in increasing reserve requirements and the power that was given to them through the Banking Act of 1935—of doubling the reserve requirements was not sufficient to extinguish the supply of excess reserves. After the last action of the Board, there were still Four Billion or more Dollars of excess reserves.

The large supply of excess reserves was due largely to government action through the purchase of gold and silver, particularly from abroad. As a result, this purchase plus the amount of government bonds that the banks purchased, as well as some increase in loans, brought the deposits of the banks—demand deposits and currency outstanding—to an all-time high level, a level in excess of \$45,000,000,000 as compared with \$28,000,000,000 at the time of the last world war.

I am merely mentioning this to indicate to you that the interest rate is an artificial thing and has been brought about by the excess reserves, largely from the silver and gold purchases, and in the first instance through the open market operations in 1932-33, which put money back into the banks.

Some people believe that you can control inflation by high interest rates, just as some think you can stop deflation by low interest rates.

In the last war, we had very high interest rates prevailing all during that period. The discount rate was, I think, around 5 per cent. Banks were getting 7, 8, 9, and 10 per cent for their loans. The government was paying $4\frac{1}{2}$ per cent on

tax-free government securities. The banks were also borrowing from the reserve system more than a billion dollars all during that period. Now there was an artificially high rate situation which was entirely unnecessary, but the high rates did not stop inflation. If you will recall, in a period of two years and certainly not to exceed three years, there was an inflation of 100 percent. Likewise in 1929, a high interest rate did not stop speculative inflation in the stock market. Neither did a low interest rate in the early 30's or the middle 30's stop deflation and bring about recovery. All this is quite contrary to what is the popular orthodox belief about the effect and influence of the interest rate on both inflation and deflation. ← The interest rate can create a climate favorable to recovery in deflation- if certain other things are done, too, just as a high interest rate can tend to create a climate favorable to stopping inflationary developments-if many other things are done.

In deflation, we want to discourage savings. We want people to spend! We want business to spend! We want credit to be used and interest rates to do whatever they can to discourage savings and encourage spending and borrowing! In times of deflation we want taxes to bear down as little as possible on consumers. We should have few if any excise taxes, because the deflation is largely due to the inability of the people to purchase the products that we have the facilities to produce. We want to encourage in every way we can and make it possible for people to purchase as much ~~many~~ goods as they ~~can~~ *need & then to do so.*

The government spending program is a great force in creating purchasing power and in creating new deposits. We want the government in a period of deflation to borrow from the banks and not from the public. We want the public to borrow from the banks. In other words, in deflation, we want to have the fiscal and the monetary program be the direct opposite from what we would agree should be applied in inflation.

Now I want to talk to you in more detail about the problems of inflation. We didn't get inflation in spite of all that the government spent prior to the defense effort. We didn't get full recovery because we did not carry through the program. It was looked upon purely as an emergency. As a certain amount of recovery developed and as private industry increased ^{its} their employment, then the government would decrease ^{its} theirs. Therefore we never got over about 70 percent of full employment, although ^{it was} they were down to 50 percent at the bottom of the depression.

We did get some recovery as a result of this program, although it was at times halting, uncertain, and ^{was considerable} inexcusable to a great many people of this country and particularly to business men and to bankers.

P. 7 When the defense program commenced, we had a lot of idle men and unused capacity. Through the large government spending that has taken place through the past year it has been possible to produce what has been produced, to build what has been built for defense purposes. We have been able to aid democracies and still to add to and increase the supply of consumers' goods beyond any point ~~that has~~ yet ~~been~~ reached.

The standard of living of the people of this country during the past year is the highest ~~that has ever been~~ attained in our history. In addition to that, we have spent far more for defense and for aid to the British than was ever spent in any three or four years of a government spending program. It is only recently that on many fronts we are reaching the bounds of our capacity.

If it were not for the particular type of public spending that we have undertaken, we could reduce the public spending as the supply of labor and raw materials became short. Then the compensatory theory would work, and we would have the highest national income we have ever had. We would have, too, the largest revenue from taxes that we have ever had, and we could then taper off those expenditures

just as fast as it was necessary to ~~free~~ ^{and} shortages and no faster. We could direct expenditures in those fields where there is not ~~any~~ ⁱⁿ shortage of materials and labor. ← As it is, however, we have an entirely different problem to deal with. We cannot by the curtailment of public expenditures reduce the dangers of inflation, except as it is possible to reduce other than defense expenditures and at the most that is a drop in the bucket.

It therefore means that in the absence of our ability to reduce defense expenditures we must find other means of dealing with this problem. The size of our problem and its gravity will be recognized if you consider that in the past fiscal year ~~there~~ ^{for} (has been) not more than about 15 percent of the national income spent of defense purposes--possibly \$12,000,000,000. In the present year, it is expected that we will increase and (possibly) spend double that amount, which will mean 25 to 30 percent of the national income. In the following year it will mean increasing those expenditures to (possibly) between 40 and 45 percent of the national income.

This means that more and more of the man power and the products of industry must be devoted to the defense effort, and that the problem is even more grave than the 40 or 45 percent of the national income indicates.

How can we avoid inflation? In the face of this kind of an effort, when we are putting more and more purchasing power into the hands of business, labor and farmers. It is only the fixed income group that suffers...those who do not get the increased purchasing power. It is a case of diminishing the supply of labor and goods and factories devoted to the production of civilian goods and increasing the purchasing power with which to buy civilian goods. All that is going to be available for civilian use will be what is left over after the defense needs are met.

Germany and England have a way of meeting inflation--it is by the direct method. We would like to avoid~~ed~~ their methods as far as possible, and I should like to see us use the functional method instead of the direct method.

It is true that a certain amount of direct control is essential where there is a shortage of particular strategic materials that are necessary for defense. Where such ^a shortage exists, there must be an allocation of those goods or materials, which in turn calls for price fixing. Otherwise, it would be a question of who has the longest purse. The government would be bidding against industry to get a supply of goods that is entirely inadequate. Therefore, in such instances, allocation is necessary. Wherever we have allocation, then price fixing is the corollary and is essential to the extent that the demand for materials increases beyond the supply and beyond the possibility of increasing production to meet that supply.

You will find that shortages ^{will} occur and allocations ^{will} extend, then price fixing will extend on and on down the line. To carry it through to its final conclusion, you will have to have rationing of a great many things. Then as rationing and price fixing increases, the purchasing power that is in the hands of the people is not so important, because there is ^{little} ~~nothing~~ they can do with their purchasing power,

Think of the immensity of any such program, ^{if direct controls} in an economy the size of ours with its diversity of opinion, with its different nationalities, with its diverse interests. It is staggering to think about and only under the most serious war conditions, conditions equivalent to those of the British, would it be possible, in my opinion, to carry out such a program. Therefore, in order to make it unnecessary to carry this allocation and price fixing right down to the retailer and the ultimate

consumer, we must with the support of everyone, understand and put into effect the ~~most~~ ^{more} democratic kind of functional powers that are in accordance with our democratic policies. Through these functional powers, we must dampen or reduce the total amount of consumer buying. We must encourage to the fullest extent the purchase of government securities and stimulate as much as possible the confidence of the people in government securities and help to create a demand for them.

omit The German inflation was brought about largely through the financing of the government through bank purchases of government securities. You can have inflation just about as easy that way as any other.

With this in mind, we should find ways and means of financing more and more of the government's needs outside of the banks. There should be less and less expansion of bank loans and investments. This is necessary to create a climate in which we may find it possible to control inflation, at least to some extent.

The control of installment credit is a direct control of credit, and I hope it will not be necessary to ^{supplement} ~~further exert~~ it through the ^{direct} control of bank credit. I think that that problem is almost as difficult as the problem of carrying out rationing powers. Installment credit control was necessary not because of the credit extended by banks--that is a small part of installment credit. We know that the inflation in the stock market in 1929 was not due to bank expansion of credit, but to the loans made by others outside of the banks who had idle funds to invest. Because there were so many institutions that have idle funds and who were only too glad to finance installment credit, it was necessary to reach out and use direct means of control.

← There are possibly ten times as many people and concerns outside the banking system as there are in it who are loaning money for installment purposes. It serves no useful purpose to permit them to enable people to discount their salaries, when their income is at the highest peak, and to borrow against

future earnings. To the extent that we can restrict and dampen consumer credit, we will obtain the same effect as we would by putting the same amount into savings bonds, taxes, or if that much were placed into savings in any other form. This is one form of deflationary action. Though it too is only one drop in the bucket. However, installment credit is almost certain to be tightened with the purpose not of curtailing production but of bringing demand into proper relationship with the goods that can be produced, after the defense goods are taken care of.

One of the most effective means of dealing with this inflation problem is by taxes. If it were not necessary to increase government spending for defense, now would be the time to decrease expenditures and increase taxes so as to bring about a balanced budget. Because it is not politically feasible although it is theoretically feasible, we must do what we can ^{through the tax mechanism} along that line. When the government is pouring out billions of dollars to people and to industry, they should be able to take a large portion of it all back through taxes.

To the extent that they don't get it all back, they should finance the difference through the sale of government securities. If the government pays out \$30,000,000,000 they should ultimately get back \$20,000,000,000, and the \$10,000,000,000 difference should be covered by the sale of bonds to investors and savers. In this way, they are in effect preventing any inflationary effect from the government expenditures, because if the savers buy the government securities, they don't have the same funds to use ^{For the} to purchase ^{of} goods. What they pay out in taxes ^{likewise} they don't have to use to buy goods. Therefore, you can see how important it is to sell as many securities as possible to savers, both corporate and individual, and how important it is to have a tax system that will reduce purchasing power.

Now I want to make this exception regarding the tax system. Many people have felt that we should have a general sales tax. I have been very much against that sort of thing. It isn't equitable, and it is very necessary to have things equitable if we are going to have and keep morale in our defense program.

It is important that the lower income group who have not had a decent living, based on the capacity and ability of this country to furnish it, should not bear the burden of a general sales tax. It is not proper to try to push their standard of living beyond a point necessary to maintain health and morale. Certainly, if we are ^{to have} ~~to have~~ ⁱⁿ priorities and allocation, the business man will get no more suits or clothes than the worker, neither should he obtain ^{more} ~~other clothing or~~ foodstuffs where there is a shortage. S

This is very important in the interest of the preservation of the morale which is necessary in the preservation of democracy...and a minimum should be established. ^{has} ~~so that~~ we cannot put the taxes on from the bottom. I am one of those who pays from the top, and I am willing to keep on paying ~~them~~ from the top and to pay more and more and more...before I am willing to encourage putting such taxes on the very low income group ^{as well} ~~so~~ to reduce them to a point where either their morale or their health is impaired. S

There are going to be enough essential foodstuffs and clothing, from all we can see now, to provide adequately for all the people in this country. However, the standard of living must be reduced insofar as the non-essentials are concerned. Many things we have thought were essential, we are going to find are really non-essential. The standard of living will be reduced either by increased savings, higher taxes, less consumer credit or it will be diminished by inflation. S

After defense is taken care of, there is just going to be so much left, and that means that there is going to be less and less consumer goods that we can purchase.

Recently I have heard many business men say...for a long time I've had no profits or very low profits. Now is the time for me to make some real profits...to build up reserves out of profits for the depression that may come.

The laborer says...I was out of work a long time, I've received low wages.. only had part time employment for years ...now I'm going to get mine. I'm going to make up now for what I have failed to get.

The farmer says...I've suffered for years and never got the proper share of national income, and now I'm going to get mine, too.

How can our economy as a whole, I ask you, get what it has failed to produce in the past. You cannot go back today and get what you lost or failed to get yesterday.

It is up to the business man and the bankers to provide the leadership that will make the sacrifice and set the example. You cannot expect the laborer and the farmer to do it, and there is no particular system that can bring it about without some example being set from the top. I have felt--not because I am unfriendly to labor--because I have always been a friend of social legislation that gives labor some of the rights to which they are entitled. I have always been favorable to keeping the taxes down on those in the lowest income groups and in favor of increasing their purchasing power wherever possible. I am not in favor, under these conditions, of a continuation of the wage spiral. This is not the time to use coercive methods - whether it is done by labor or agriculture or any other particular group of people.

If we want to avoid the terrible blight of inflation, it can only be done by an understanding of the gravity of the situation, by a realization that everyone will ultimately suffer tremendously if it comes about, by a realization that capital in the final analysis may be wiped out, or at least capitalism will be wiped out, by the realization that our great fiduciary, savings, and trust funds may likewise be wiped out. This is not a problem that can be corrected by half-hearted measures or half-hearted support.

The business man must not think only of the profits he can make or the interest return he can get, of the dividends or rentals or capital gain or what-not. He must not think that now is the time to pay big wages and salaries because Uncle Sam is going to take it if he doesn't. You can't contribute to inflation more than to pursue that policy.

If labor continues to think that through higher wages they are going to help themselves as a class, they are certainly going to be fooled.

There is one more thing that bankers in particular are concerned about — the government becoming bankrupt. I want to say to you that the only way that there can be such a bankruptcy is in a financial sense--individually and not collectively.

← No nation can be bankrupt as long as it has all of the man power, and all the productive facilities and the raw materials that it had before. It is true that individuals may be bankrupt and corporations may be bankrupt, but not all of them. This country as a whole, when this defense effort is over, will have ~~probably~~ the same wealth--the real wealth--it had before and maybe more. We shall have more skilled workmen, we shall have a greater capacity for production, and we shall have more facilities and a greater population than ever before.

Bankruptcy can only be brought about in the case of individuals and corporations. The nation as a whole will not become bankrupt. The public debt will not bring about bankruptcy and the government cannot be bankrupt. It is only the way the public debt is financed that can bring about the disasters of inflation.

If you will stop to think about the debts of the government, you'll discover that the debt of the government is a debt of the economy as a whole. It is not the government--it is all of us. In effect, all of us owe to all of us whatever the public debt is. What the government collects in taxes to pay the interest on the public debt will be collected from the economy as a whole, and the interest will be paid to the economy as whole.

The idea of thinking that we are leaving a great burden on our children and our children's children is wrong. The mortgage, which is the government's bonds, we are bequeathing to posterity as well as the debt.

If we were getting our funds from abroad in the form of goods and we had to ship goods out of our country and thus reduce our standard of living because of the fact that we had incurred a debt in a foreign country, then that debt would have to be paid by labor and materials that would have to be sent outside of our country. That would be an entirely different story.

It is unfortunate that public expenditures cannot be made for more useful things than battleships, tanks, and guns, but it cannot be more wasteful to employ men and materials to produce things that are useless in an economic sense than it is to fail to employ men and materials and to keep industry **idle!**

I thank you,