



Z-271

CAN WE CONTROL A WAR BOOM IN AGRICULTURE?

Address by

Chester C. Davis,
Member, Board of Governors,
Federal Reserve System,
Washington, D. C.

Before the Fourth Annual Session
of the
National Farm Institute,
Des Moines, Iowa,

Friday evening, February 23, 1940.

FOR RELEASE IN MORNING NEWSPAPERS
OF SATURDAY, FEBRUARY 24, 1940.

CAN WE CONTROL A WAR BOOM IN AGRICULTURE?

This subject is ideal for the "if and when, but on the other hand" kind of treatment. The unknowns outnumber the knowns in the equation. If a man speaks positively, events a year or two from now may contradict everything he says; yet if he doesn't speak with conviction, the audience may walk out on him.

Tonight's speakers, therefore, are caught between the rock and the hard place. There is nothing to do but to state our opinions as if they are facts, and hope that time will be good to us.

Before we can talk about power to control a boom or to offset or limit its consequences, it is important to form a judgment on the probable effects of the war on American agriculture and American industry. My answer to the basic question "Are we going to have a war boom in agriculture?" is "no". Perhaps hope is the father of my opinion, because with all my heart I sincerely hope there will be none.

I realize that I may be wrong. Some well-known authorities feel otherwise. Former President Hoover, for example, is quoted by the Associated Press as advising the nation to get set for a boom in agricultural production as a result of the war in Europe. "After the last war", Mr. Hoover is quoted as saying, "we exported more food in ten months than we have during the last five or six years. The same processes are in action now, and the same situation will some day arise."

If he was quoted correctly, I think that he is mistaken. But whether he is right or wrong, it is of highest importance that American

farmers go on about their business as nearly as possible as if they had never even heard of the European war.

American farmers haven't yet completed the adjustments made necessary by the effects of the last war; if they expand their plantings in anticipation that higher prices and enlarged demand will result from this one, they will be headed for more trouble than this generation is going to be able to mop up. For unless they hold their lines firm against war influences, every dollar of war business they get will cost them a good deal more than a dollar in the long run.

It is conceivable that a war boom for agriculture might be set in motion if during the next two or three years export orders for large quantities of wheat and cotton, meat and lard, were concentrated here in the same spirit of "get the goods and hang the expense" that featured the old war. It is conceivable also that certain branches of agriculture will be indirectly stimulated if huge war orders for manufactured goods help to maintain pay rolls and purchasing power of factory workers at a high level during the next year or two.

I do not believe either is likely to happen in boom proportions as a result of this war. It would be a tragic mistake for farmers to expect it and to act accordingly.

Those who predict a powerful war export demand for our farm products reason from the experiences of the last World War. It happened then, therefore it will happen now. But there is a vast difference between conditions then and now. I think the differences are more significant than the similarities.

On the supply side, world stocks of essential farm raw materials are much greater than they were at the outbreak of World War No. 1.

Wheat stocks on July 1, 1914, were estimated at 3,459,000,000 bushels; they were 5,330,000,000 on July 1, 1939, an increase of nearly two billion bushels. Total annual international movement of wheat has dropped from between 800 and 900 million bushels to around 500 million bushels, indicating the extent to which wheat importing countries have moved toward self-sufficiency. But on the other hand, world wheat stock figures do not tell a fair story. Since July 1, the wheat prospect in this country has been lowered radically by bad weather in the winter wheat belt. Apparently a short wheat crop is being harvested in Argentine.

Total world stocks of American cotton were 3,300,000 bales on August 1, 1914. They were 14,000,000 bales on August 1, 1939. Meanwhile, synthetic fibers have vastly decreased dependence on farmers for clothing and cellulose. In general, the outbreak of the present war found supplies of farm products abundant in the United States.

On the demand side, all belligerents start this war with strict rationing of domestic consumption and, for the most part, with machinery to fix and control prices. The Allies start with centralized monopoly buying. They all have rigid exchange control, and absolute government direction of imports and exports. At the outset their trade controls are experienced, and organized with far greater efficiency than they had attained at the close of the old war.

While military developments are unpredictable, it is at least an open question whether the present war ever develops into the mass struggle of millions of men on the battle fields such as marked the previous one. On the west front the fortified lines are so extensive and strong that little room is left for maneuvers in numbers. Whether another front will develop on which millions of men can come to death grip, is a question. I doubt whether any government involved, England or Germany or France or Russia, could long survive if this war starts wasting lives at the rate the last war slaughtered its soldiers.

These are some of the points of difference between 1914 and 1940. All wars are similar in some respects. Each side will go to any length to win. If food and raw materials from the United States are necessary to carry on a nation at war, prices will not stop purchase as long as means of payment exist.

But even this prospect is qualified. This time the Allies won't buy American food and farm raw materials if there is any way to avoid it. They want the dollar exchange which they have or can buy with gold or investments to pay for airplanes, motor equipment and munitions of war which they can get here and nowhere else. They will buy wheat and meat where they can pay for it with sterling exchange or exports.

We are not going to be able to sell our crops to blockaded Germany and her associates. England and France won't buy from us a single pound that they can get somewhere else. I can only see one

possible development that might send Allied orders our way in large volume, and that would be a U-boat blockade so successful as to make shipments from the Southern Hemisphere too risky and costly to undertake.

It isn't necessary to speculate about the effect of Allied import policy on American agriculture; we've already had enough examples or it to realize that the war will seriously hurt the foreign market for many of our crops. England stopped outright all purchases of American tobacco, partly because her stocks were large and she wanted to conserve dollar exchange, and partly because her government wants to throw all the trade it can to Turkey. If our government hadn't stepped in and in effect bought what England normally takes, the effect on the tobacco farmers would have been disastrous. The same thing happened to California raisins. Great Britain and France admit Canadian and bar American apples. England by one move took over the Australian, New Zealand and Indian wool crops at a set price for what she requires and, according to reports, expects to sell the remainder to the United States at a not inconsiderable profit.

This could be extended indefinitely, not in criticism of England but as a matter-of-fact recital of how a nation behaves in a modern totalitarian war. If there is anything in the picture to justify the expectation that we are facing an export demand for farm products in volume sufficient to start a boom, I confess I cannot see it. The Allied powers are now buying and will continue to buy more

heavily from their own Empire than they did before. The productive power of the Dominions is vastly greater than it was 25 years ago. The Balkan states and Turkey will get all the business the Allies can throw their way if for no other reason than to prevent their agricultural surpluses from getting to Germany.

Now let's take a look at the means of payment available to those belligerents who are able to buy our goods and haul them away.

Our expanded agricultural exports during and after the last war were financed by the credit we extended to the buyers. The continuation of our shipments abroad during the 'twenties also was made possible by the credit we gave. In recent years, the excess in dollar value of our exports over our imports has been settled by our purchase of gold from abroad. Since 1934, about ten billion dollars worth of gold has flowed into this country. Most of this represented capital seeking safety or opportunity for investment here. Part of it, - about \$2,200,000,000 - came in to pay for our exports in excess of our imports.

The Allies have quite a fund available for expenditure in this country and elsewhere for materials necessary to their conduct of the war. Counting dollar balances, and short-term liquid investments in this country, and including \$5,755,000,000 of central gold reserves, the funds available to England and France probably amounted to about \$8,500,000,000 at the outbreak of war on September 1.

Not all of this will be spent in the United States. Probably as little of it as possible will be spent for American farm products.

Will this expenditure in the United States during 1940, 1941 and 1942 create a general war boom here, in which agriculture will share?

There seems to be agreement that if the war lasts a long time and is highly destructive, the demands on the industrial plant of this country by belligerents having access to our markets may be very great on the basis of resources available here without borrowing. The United Kingdom, France, Canada, and other British and French countries can keep on selling us goods and new gold currently produced in the amount of about \$750,000,000 a year and in addition can use their large holdings of gold (\$5,750,000,000), their balances at banks in this country (\$1,250,000,000), and their holdings of American securities (\$1,400,000,000) to pay for whatever they must have. Should all of these resources be expended in a period of a year or two under conditions demanding promptness of delivery, the effect on volume of industrial output and on prices of industrial products in this country would undoubtedly be important.

But many observers do not expect in the near future war developments of a type that would force Great Britain and her allies to make any such large purchases here. They point out that these countries are restricting civilian consumption, that they have stores of military supplies of many types, and that the war may continue to be of a blockade type. In that case war demands during 1940 at least will be only an extension of the rearmament program that has been going on for

several years already. These observers, then, hold the view that there will be an increase in shipments abroad but that it will not become a controlling factor in the domestic business situation. They attribute the rise last fall in part to inventory buying. They are convinced that export volume in the near future will not be sufficient to stimulate a business boom, particularly as industrial output is now declining and, as in most industries, there is considerable unused capacity available.

There you have the two views. Any estimate and forecast that seems reasonable now may be altered quickly by events no man can anticipate. Most of the men I have talked with do not expect an industrial boom to result from war orders placed with our factories.

They expect exports of industrial products, while the war and the resources last, will continue well above pre-1940 levels. They expect the displacement of our agricultural exports by industrial exports to continue at an accelerated trend. They recognize that events since last September indicate clearly how developments abroad may affect domestic markets and business volume even though actually export orders contribute only a small part of the total of national activity.

In short, they expect the war business to be a support to business activity and employment while it lasts, but they do not expect it to create another 1918 or 1919.

On the basis of the whole analysis it looks to me as though war orders will stimulate certain lines of factory production directly

and decisively; that the stimulation to agriculture will be more indirect and sympathetic than direct; and that nothing like the effects the old war had on farming in this country is in the cards.

It isn't necessary to tell this audience what the last war did to American agriculture. We planted 27 million additional acres to our ten major crops, principally in wheat with 21,300,000 new acres. The method of financing the war here and elsewhere was highly inflationary. In the one fiscal year 1918-1919 national expenditures exceeded national receipts by 13 billions of dollars in the United States, 8 billions in England and 6 billions in France. Prices went to levels that could not be sustained. Farm land prices sky-rocketed to the great disadvantage of the farmers. Everybody and his brother speculated in land. Here in Iowa, according to Department of Agriculture figures, farm land prices rose from an average of \$96 per acre in 1910 to \$227 an acre in 1920. They had dropped back to \$124 in 1930. Farm mortgage debt rose accordingly and did not drop.

I've used up most of my time telling why I think we are not going to have that kind of a war boom in agriculture this time, and yet my question is, can we control one if it starts?

We certainly can if we have the courage and the good sense we ought to have. The trouble is that when a boom gets under way nobody likes to do the things that are necessary to keep it from getting out of hand. Before listing some of the unpleasant medicines for boom control, let me state two general courses of action which I am assuming the United States will follow:

1. We will not commit the incredible folly of engaging in this war either on the Atlantic or the Pacific scenes of action.
2. We will not finance their war for them by grants of credit. When the time comes we ought to be willing to lend or even give for peace, but not for war.

If the United States will hold the line against war credit, the expenditures in this country that will be paid for out of the liquid assets of the belligerents will probably not be sufficient to cause any runaway expansion.

War orders that are placed here will have some effect on our economy. If they provide enough stimulus to reduce factory unemployment substantially, then Federal relief expenditures and deficit financing should be correspondingly reduced.

If the patient's temperature begins to rise with symptoms resembling those of the business fever that accompanied the old war, stiff and courageous taxation would be an effective antidote and would at the same time offer the opportunity to balance the budget and reduce the Federal debt.

In the course of the war, much more of the world's monetary gold will probably come into the possession of the United States. If we follow present policies, that gold will add dollar for dollar to our bank reserves and to our money supply, i.e., bank deposits and currency in circulation. If we wish to prevent its infusion into the money supply, it is only necessary to borrow the money that pays for the

gold -- sterilize the gold purchases is the short term for it. Since that involves adding \$35 to the public debt for every ounce of gold that is bought, the practice lacks political sex appeal.

Without getting too far afield in technical discussion, it should be mentioned that the banking system already has over five billions of dollars in excess reserves, and if the United States buys another five billions of monetary gold during the course of this war, and other factors remain about the same, we will find ourselves with excess reserves of close to ten billions of dollars. These reserves are high-powered. That is, if they are fully used by the banking system as a whole, a multiple expansion of credit many times the volume of the excess reserves would result. A dangerous credit expansion from that quarter could be headed off if Congress would grant the Federal Reserve authorities power to fix bank reserve requirements at whatever point became necessary for monetary safety.

None of these boom antidotes would be popular when the time came to apply them. When business booms and tax revenues are rising, there is always a clamor for reducing tax rates, not raising them -- witness the 'twenties. Banks and investors want higher interest rates, but they like the present swollen condition of reserves, too, and the thought of increased reserve requirements is very distasteful to them.

These considerations have strayed away from the strictly agricultural problem assigned to me. If war orders in volume strike the American farmer -- which I consider unlikely -- the danger to be guarded

against is that farmers will again expand and rearrange their plant on the war-time basis. This, I think, would be a terribly stupid thing for us to do, but it has been done before and might happen again.

Fortunately the machinery exists now that did not exist in the old war which the farmers can use if they will to keep their course straight in spite of the war winds. They now have a functioning machine which extends not only into each county but into each agricultural township by means of which economic information can be brought home to every farmer. They do not have to depend on emotionalism or speculative promptings for their outlook on agricultural prospects.

I believe the farmers of the United States should resist every urge to alter their course to accommodate a doubtful European war demand. I believe the machinery of the Agricultural Adjustment Administration should be improved and strengthened and used to hold the line where it is. Certainly there is no present need to plant or breed for another pound of grain or fiber or meat because of any war orders in sight. There will be plenty of time for expansion later if it appears necessary to step up production to prevent prices from reaching levels that are unfair to the American consumers.

I doubt if the present law and mechanism could put the brakes on war-time expansion if the unexpected happened and a flood of war orders hit us. The power of an adjustment program to induce cooperation by making it economically worth while to cooperate grows less as prices rise and the temptation to expand acreage pulls harder at the individual farmer. This presents a problem that should have the immediate study

of the agricultural leaders inside and outside of government.

I have puzzled quite a bit over how to close my talk here tonight. I have the queer feeling that the things we've been speaking about are not really the things we are thinking about at all in our innermost layers of consciousness. We are all of us in reality caught in the grip of a great amazement at a world gone utterly mad. We ask ourselves what is in store for the world, and for us in it, and we cannot answer. But there are one or two things on which we can fix our minds.

First and foremost, the counsel of sanity teaches us that we cannot help the world or ourselves by getting into this war, but that we may be able to help the world greatly and ourselves with it in constructing a fair and enduring peace when the collapse of one side or the sheer exhaustion of both forces a truce. In the meantime plenty of man-sized problems here at home are challenging us. Let me close by mentioning one to which we must find the answer in spite of the fact that it hasn't been answered yet. It would be a healthy demonstration if the United States could show the world that here is one mature nation that doesn't have to go to war to lick its unemployment problem. If we feel we've got to fight, let's get together and fight that one.