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RECOVERY AND THE FEDERAL DEBT

By

Ernest G. Draper, Member of the Board of Governors
Of The Federal Reserve System

Speaking of the Federal debt, some people say "You cannot spend your way to prosperity just as you cannot drink yourself sober". This sounds convincing. But is it true? You can spend your way to prosperity, if you spend with a sound, long range purpose in mind. The pages of industrial history are filled with examples of farseeing executives who developed a needed product and then went in the red for years before their heavy advertising and sales promotion campaigns finally bore fruit in the form of prosperous net profits. Also, you can drink yourself sober-- if you only drink water. And somewhat as the human system needs water in order to survive, so the economic system sometimes needs carefully planned and properly timed Government investment in order to save it from the worst effects of a nation-wide breakdown.

If the capitalistic economy is made to function as we desire, every able-bodied citizen who is willing and anxious to work should be able to find employment in private industry. One requirement to this end is that private initiative should

have free scope in so far as its functioning does not run counter to the public interest. Capital should have a reasonable prospect of a profitable return in every useful field if it is to achieve the full employment of industrial and farm labor.

We must admit, however, that there are times when for one reason or another, the system of private industry partially stalls. What should we do then? It seems reasonable that when production and trade decline over a wide front for many months, the Government must step in and take up some of the slack.

But to supplement private income through Government investment in a depression, whether in 1931, 1934 or 1938, inevitably requires that the Government run up budget deficits. With a tax system that is geared to incomes, it takes either impossible increases in tax rates, or else annual deficits, even to hold basic Government activities unchanged in a depression. And when relief and public works expenditures are added there must be still larger deficits.

Borrowing, therefore, has been necessary and the Federal Government debt held today by the public has increased in 8 years, from 15 billions to 36 billions.

II

What does this increase in the Federal debt mean in its effect upon our economy? To the extent that expenditures have added to national wealth, whether or not they promise future monetary returns to the Government, they have in most cases created capital assets. But the Government also has other assets, like the R.F.C.'s investment in banks, which are simply obligations whose future repayment, under prosperous conditions, is as certain as the payment of any debt that is backed by prime collateral.

Let us note, too, that the Treasury has not had the slightest difficulty in marketing either its long or short term obligations. Because of the abundance of available funds, interest rates on Government securities, like rates on all other prime investments have fallen to unheard-of lows. The consequence is that in carrying a debt that is 100% larger than in 1926, the interest cost to the Treasury is only 25% greater than the 1926 interest cost -- a sum of approximately \$200,000,000 per year. Obviously, the additional "burden" on the present generation, imposed by Government borrowing, has not been unduly oppressive.

But, we are told, we are placing an intolerable burden on future generations. How is the debt ever to be paid off? Retirement of debt is indeed impossible under depression or semi-depression conditions, but not when the country is prosperous. It is inconceivable that the economic machine will forever run in low gear. All the weight of the evidence indicates that sooner or later the national income will reach and pass the 75-80 billion dollar mark.

As business activity approaches and surpasses this level -- which it must do in order to give relatively full employment to an enlarged population, just as it once did for the population in the 1920's -- expenditures for relief and public works will be lessened. The Treasury might then be able to reduce the debt by as much as 2 billions a year.

III

We have been through such a long period of discouragement since 1929 that we tend to think that prosperity will never again really take hold. But the chances are that just as it has gotten under way in the past, it will do so again. If another year or two passes safely by, we may hope to be on the road to sustained recovery. Construction activity is at last

showing signs of a real upward trend, and if we may judge by the experience of the 1920's, this should mean an increased underlying demand for several years ahead. Even so, we must still be pessimistic about our chances of permanently curing the grave unemployment problem.

We must admit that the system of private enterprise faces a difficult task in this age in which our continent has ceased to expand and its cities are no longer rapidly filling up. The economic scaffolding of our civilization has been weakened. We must recognize that there will be times in the future when the Government will have to shore up this scaffolding.

When prosperity really takes a firm grip upon our economy, we must reduce the Government debt as much as revenues in the prosperous years will allow. But, in the meantime, we need not be overwhelmed by anxiety about the "crushing burden of debt", since these words are little more than an obvious exaggeration of the facts. Let us, rather, face the real issues. Let us explore, study and, if possible, adopt

every effective means whereby we may hope to solve the difficult problem of keeping our system of free enterprise functioning as we desire.

(Signed) Ernest G. Draper

P.S. The above remarks are my personal views and are in no sense to be considered as an official view point of the Federal Reserve System.

E.G.D.