I appreciate this opportunity to speak at your first postwar convention. It brings me almost full circle to the place where I had my initial contact with banking from the inside - and I wasn't very far inside. That was back in 1920 when I was employed as a bank agriculturist by the First National Banks of El Monte and Puente. I didn't last very long there; the citrus and walnut growers, and the dairymen of that rich section knew more about their business than I did, even though the idea was and still is a good one. The banks lasted a little longer, but eventually became branches of the Bank of America, a not unusual thing. I am sorry the Bank of America is not here today, inasmuch as that would seem to make me a former employee, once or twice removed.

I went on to the Federal Reserve Bank of San Francisco in time to see something of the financial aftermath of World War I, when our new and relatively untried central banking system grappled with the destructive forces of a postwar inflation and deflation. The medicine finally used was bitter and the results drastic. But the patient survived and grew robust. There is doubt, however, whether our economy would again submit to such treatment, even if it were deemed desirable and even if there were the confidence in monetary measures which then existed. Severe deflation in the United States, with all that it might mean in terms of declining prices, curtailed production and widespread unemployment is not a part of the arsenal of democracy at this particular moment in world affairs. And yet, with all of the experience we have gained in the past twenty-five years, we are not absolutely sure how much we can sugar-coat the pill. This is the problem which I wish mainly to discuss.

It was said in jest, but not without meaning at the beginning of World War II that, in war, the role of finance is to get out of the way of production. Certainly, after fighting men with fighting hearts, production was the key to victory in the war which ended last year. No country permitted its finances to interfere with its war effort. If the mistakenly labeled sinews of war could not be raised by taxes, they could be borrowed from the public, and if they could not be borrowed from the public, they could be borrowed from the banks. And if they could not be borrowed from the banks, they could be borrowed from the central bank, or the printing presses could be started. We did all of these things except the last and worst, and there are some who claim we did a little of that.

It does make a great deal of difference, however, how you do it, both during the war and with respect to the kind of monetary headache you will have when the war is over. The primary recourse should be to increased taxation, and this should only be limited by the requirements of keeping the economy going full blast on the production front. The next line of defense, or attack, is borrowing from others than banks so as to avoid an undue expansion of credit, and so as to channel increased incomes into Government service rather than leaving them free to undermine the dikes of price control and wage control, and rationing. On the whole
I think we did a good job; far from perfect but based on past performance better than we might have expected. Beginning with January 1941, shortly after the start of the defense program, the Federal Government spent $378 billion. Of this amount $150 billion, or 40 per cent, was raised through taxes, most of which carried no future call on the Government for reimbursement. Another $134 billion, or 35 per cent, was raised by borrowing from others than banks. Of the remainder, $72 billion, or 19 per cent, came from the commercial banks and $22 billion, or 6 per cent, from the Federal Reserve Banks, the latter purchases being necessary to enable the commercial banks to play the role they did without heavy borrowing from the Reserve Banks.

It was this latter borrowing by the Treasury from the banks, plus the loans made by banks to purchase or carry Government securities, which resulted in or was a reflection of the great increase in bank deposits and currency held by the public during the war. Here is a figure between $75 and $100 billion of readily available purchasing power. And behind that is an approximately equal increase in the amount of Government securities held by individuals and businesses, which may readily be converted into money. This is a financial legacy of the war, in addition to the greatly increased public debt. It has been the financial legacy of war in every country. It shows itself as an enormous increase in the money supply in relation to the goods and services available for consumption. That might become the meat on which inflation would feed. We must see that this does not happen here.

Our situation is not desperate, as it is in some of the countries of eastern Europe and in Asia, nor is it so difficult as in the former occupied countries of western Europe and in the countries of some of our allies. All of these, as well as the neutral countries, experienced a tremendous increase in the public debt of the national government and in the amount of currency in circulation and the amount of bank deposits. War, as it is now fought, spares neither belligerent nor neutral economies. Some of them, such as France, Belgium, and the Netherlands in the west, and most of eastern European countries where currency chaos was greatest, have had to take drastic steps to reduce the money supply in an attempt to head off inflation. In general, these measures have provided for the withdrawal of practically all outstanding currency, the limited issue of new currency, and the freezing of a large part of the bank deposits existing immediately prior to the promulgation of the currency decrees. In most cases these monetary reform laws have contributed to economic and financial reconstruction in that they have sterilized a large part of the huge liquid funds accumulated during the war period. Inflationary price movements, to the extent that they were being fed by the spending of those funds, were held in check and black markets curtailed. Nevertheless, the ineffectiveness of such decrees in two countries - Hungary and Greece - and the reappearance recently of currency disturbances in some of the other countries, serves to remind us of the fact that complete monetary rehabilitation cannot be attained without the improvement of basic supply-demand conditions, and the adoption of fiscal and economic (as well as monetary) policies which strengthen public confidence in a nation's credit and its currency.

Fortunately we are not faced with the need of such drastic measures as have been taken in some other countries, nor can we admit that the solution is so simple as some of these measures might imply, necessary as they may have been in the circumstances in which they were taken. The existence of a large supply of money in relation to the supply of goods and services is not, of itself, inflation even though it may give you the feeling of wandering through a powder magazine, striking matches to light the way. As stated again in the annual report of the
Federal Reserve Bank of New York, just recently published, historically, drastic inflation has usually been associated with budgetary deficits and with deficits in a country's international balance, leading to currency depreciation. With these, and largely as a consequence of them, has gone a distrust of the currency resulting in capital flight and a panicky desire to run away from money into commodities, real estate, and equity securities. These conditions are not present in this country. The Federal deficit is rapidly diminishing and there is a highly favorable prospect of our having receipts in excess of expenditures in the fiscal year beginning July 1 next. Internationally, there is no pressure on our balance of payments and no anxiety about the external stability of the dollar - quite the reverse. There is, therefore, no fundamental distrust of our currency such as characterized the great inflations after the last war, and the inflations which have followed in the wake of the recent war.

Nevertheless, this does not mean that we can afford to ignore the monetary aspects of our problem, as it seemed we might be doing until recently. Official and some unofficial reports on reconversion have emphasized the need of increased production, and the maintenance of price controls until such increased production is achieved, almost to the exclusion of other factors in the fight against inflation, including a proper ordering of our monetary affairs. Fundamentally, of course, in a situation like the present, the antidote to inflation is a large and balanced output with rising productivity per worker. To this objective Governmental and business and labor policies must be mainly directed, and upon our success in achieving it will largely depend whether we shall lay the foundations in 1946 for a period of orderly prosperity or have an inflationary outburst terminating in depression.

A second fundamental is the avoidance of a wage-price spiral such as we had after the last war. This time, the dropping of wage controls after V-J Day, and the early sanction given to wage increases which would not require price increases developed quickly into a pretty general demand for higher wage rates. This soon forced recognition that there would have to be some accompanying rise of prices. The problem is how to stabilize this relation, because it must be stabilized if we are to avoid a fitful period of illusory prosperity followed by collapse. The modified wage policy announced by the President last February recognized the need for re-imposition of some wage-rate control and established a procedure for wage-price adjustments which may achieve a more stable relation, though the major and disastrous strikes which have since been in progress have clouded the prospect of success of the new policy. Similarly with price controls. Drawing again on the recent annual report of the Federal Reserve Bank of New York, extension of the Price Control Act seems an indispensable condition of a successful anti-inflationary policy, but the control must be flexible and should be based on recognition of the fact that price changes in a period when we are trying to work back to free markets, have an indispensable role to play in bringing out a balanced output and directing and controlling demand.

At the risk of introducing occupational bias, I must now emphasize that a third fundamental in the present fight against inflation is the existence of a redundant money supply. Increased production will take care of the side of the equation represented by goods and services, but there is also a demand side represented by purchasing power in the hands of the public and the demonstrated public desire for goods and services. It must not be forgotten that increased production will generate increased incomes, which will currently provide the means of purchasing the things produced. If this newly created income has to compete with an already large supply of liquid funds, such as we have built up during the war, we
might have inflation no matter what our production records may be. What we must do in the existing circumstances is (1) prevent a further increase in the money supply, and reduce it as opportunity offers; (2) keep present public holdings of liquid resources, in so far as possible, in their least volatile form—Government securities; and (3) facilitate a transfer of some Government securities from the banks to nonbank investors, which will mean transforming bank deposits into holdings of Government securities.

This sounds simple and logical, but it is not so easy as it sounds, and demanding courage of those who serve you in seeking a solution is less helpful than constructive suggestions as to just what should be done, and when, and how. The first and most important step, in the present circumstances, is already being taken—that is, putting our national budget in order. According to the revised budget estimates released by President Truman in April, the Treasury deficit for the fiscal year 1945-46 will be $21.7 billion, which is $6.9 billion lower than the January budget estimate. And since the actual deficit to the end of March was $17.3 billion, the anticipated deficiency for the last three months of the fiscal year was only $4.4 billion. It may, in fact, be even less. The smaller estimated deficit reflects a substantial increase in estimated receipts and a decline in estimated expenditures, some of which, however, have only been delayed, not eliminated. It seems reasonable to hope and expect that this reduction in the fiscal year's deficit, plus the excess of receipts over expenditures, which we actually experienced in the first quarter of 1946, are portents of things to come—that our Federal budget may be in cash balance this calendar year and in full financial balance during the coming fiscal year. That will mean, of course, keeping up taxes, in the aggregate, and will depend upon the maintenance of a high level of income. The first we can well stand, if the alternative is feeding the fires of inflation; and the second we can most certainly achieve if labor troubles do not rob us of the fruits of our ability to manage and use our resources. With the disappearance of Federal deficits the principal cause of increases in the money supply during recent years will have been removed.

With a reappearance of Federal surpluses some reduction in the money supply will take place, if bank-held debt is repaid. Assuredly we are entering a phase in which budget surpluses are economically desirable and socially defensible. In a situation in which our resources of men and materials can be used to the utmost in meeting domestic and foreign demands for our goods and services, and in the face of a redundant money supply, some restraint on purchasing power is necessary if the wartime savings of the public are not to be wholly frittered away in rising prices. We can provide a measure of restraint through budget surpluses. And we can have budget surpluses if work stoppages do not dry up the sources of our national income, if taxes are kept relatively high, and if non-essential and less essential Government expenditures are reduced or postponed.

Debt management policy can also be helpful and is presently being helpful. As you know, the Treasury is using some of the funds which it obtained in the Victory Loan Drive last December, and which increased its balances far in excess of current needs, to reduce the amount of the outstanding debt. This is really a conversion operation in which the horse comes after the cart. For various reasons there was a very large sale of long-term restricted bonds in the Victory Loan, and it is the proceeds of these sales which are now, in effect, being used to pay off short-term securities held largely by the banks, including the Federal Reserve Banks. The result is that some war loan deposits, which would have become private deposits if spent, and thus increased the money supply in the hands of the public, are being eliminated.
Another constructive aspect of debt management policy is the continued sale of savings bonds to the public, bearing rates which exceed those available in the market. So long as incomes remain high and goods continue in short supply, there is every reason for dampening consumer demand by encouraging substantial savings out of current income and the retention of previously accumulated savings. Not only is the continued cooperation of employers and of the banks desirable in promoting this program; a stepped-up campaign on the part of the Treasury, which I understand will soon be launched, is a necessity. There will also arise, eventually, the question of the kind of securities to be issued in refunding maturing obligations in order to absorb the supplies of investable funds accumulating (and not needed elsewhere) in the hands of insurance companies, savings banks, and other institutional and individual investors. When the present program of repaying debt out of accumulated balances is completed, this problem will have to be met.

And now I have driven myself into a corner where I must say something about restraint on further credit expansion which is the area in which I have some direct responsibility and, therefore, the area where it is most difficult to make public pronouncements. During the war the credit policy of the Federal Reserve System had two main objectives: (1) providing banks with sufficient reserves to enable them to act as residual buyers of Government securities; and (2) maintaining stability or a "pattern of rates" in the Government security market. The fact that this two-sided policy largely or wholly deprived the Federal Reserve System of the initiative with respect to the supply of credit was acceptable as a corollary of war financing needs. It is not acceptable under peacetime conditions, particularly when inflationary pressures are as strong as they are today. Our problem is to decide what is the place of quantitative credit control in the fight against inflation and how it is to be reasserted to the extent that it has a role to play. (I am purposely excluding from the discussion qualitative or selective credit controls such as control of margin requirements for purchasing and carrying listed securities, and control of consumer credit.) As matters now stand, control is largely in the market and particularly in the hands of the commercial banks. Even though we wish to prevent a further increase in the money supply, or even to bring about some contraction, you need only offer Government securities for sale to obtain more Federal Reserve credit.

That has become an undesirable or, I might say, an intolerable situation. I do not think we can expect or permit some fourteen thousand individual commercial banks to establish national credit policy for us in this critical reconversion period. We already have a redundant money supply, and a tendency toward declining interest rates which such a supply engenders. Maintenance of a "pattern of rates", because it diminishes the risks and increases the profits which come with holding long-term securities, accentuates this tendency. This combination, plus a favorable business outlook, has often in the past been a highly inflationary force, pushing up prices in all markets for both securities and commodities. I should like to think that voluntary action by the banks would meet the situation, but I am afraid that is a reed we cannot lean upon too heavily. The forces of competition, and in some cases of greed, and the difficulty of separating productive transactions from speculative excesses will be too likely to bring additional credit into use if it is readily available. In these circumstances it seems to me clear, if we are to discharge our responsibility for promoting economic stability, and for supporting the measures taken by other agencies to curb inflationary tendencies, we must combat a further decline in interest rates and must curb further credit expansion.
We have taken some steps in that direction. A return flow of currency and an increase in our gold stock, amounting to nearly $1 billion in the first four months of the year, which might otherwise have further eased the credit situation, was offset by a reduction in the Government security holdings of the Federal Reserve Banks. We have taken in the welcome mat, in the form of a preferential discount rate on advances collateralized by Government securities maturing within one year, which encouraged you to use Federal Reserve credit during the war financing period. But the door is still open. We have yet to determine if and how we can close it without bringing undue pressure on the Government security market.

I do not think any of you would advocate a really tough monetary policy — that is, resort to a drastic increase in money rates and a drastic decrease in the money supply, as an anti-inflation weapon. The consequences would be more severe than we should want or intend. I think many of you would agree that a generally higher level of interest rates on United States securities, than is now being paid by the Government, would not be desirable, having in mind the size of the public debt and the annual cost of its service, although you would undoubtedly add that if the choice is between some increase in the cost of servicing the debt and the infinitely greater costs of inflation, you would choose the former. It is within this area that we must devise a policy, using our present powers to free ourselves from the strait jacket of the "pattern of rates", and the loss of credit control which it involves, or else we might have to seek new and, perhaps, novel powers to attain the same objective. With wisdom and restraint on the part of commercial bankers, we may be able to preserve the present general level of interest rates, without endangering the whole anti-inflation program by an uncontrolled expansion of credit. If that is too much to ask or expect, however, those whose duty it is to administer credit policy in the interest of economic stability cannot shirk their responsibilities.

I should now like to make brief mention of a matter which seems to me to be of the first importance in our international economic relations, and indeed in our international political relations as well. I refer to the Anglo-American financial and trade agreements, which were recommended by representatives of our Government and the Government of the United Kingdom last December. Those agreements were promptly approved by the British Parliament, though not without some misgivings, and have been dragging their weary way through the Congress of the United States. I need not review for you, in any detail, the terms of those agreements. They are common knowledge. In essence we would grant a line of credit totaling $3,750 million to the British, plus $650 million to cover the final settlement of lend-lease and other claims arising directly out of the war, against which the British could draw at any time between the effective date of the agreement and December 31, 1951. The combined credits of $4.4 billion require no payment of principal or interest during this period. Beginning December 31, 1951, they are to be recouped in equal annual installments over a period of fifty years, the payments to include an interest charge of 2% on the outstanding principal amount in any given year. If the United Kingdom determines that its present and prospective position with respect to its international balance of payments, and the level of its gold and foreign exchange reserves make it necessary, and is supported by a certification of the International Monetary Fund as to its balance of payments position, the interest payment in any year may be waived.

These might be considered generous terms, if past sacrifices in a common cause are to be forgotten, if the future strength and stability of the British Commonwealth of Nations means nothing to us, and if this were an ordinary loan transaction. The fact is, it seems to me, that we have a vital interest in the
rehabilitation of the British economy which transcends the financial aspects of the transaction, and that there are certain collateral provisions of the agreement which make this no ordinary loan. In return for our financial help, the United Kingdom has committed itself to a system of free exchange on current account and has joined with us in "Proposals for Consideration by an International Conference on Trade and Employment," which point the way toward a revival of international trade on a multilateral basis.

Just what does that mean to us? It means a reversal of the tendency which flourished in the years between the wars, particularly during the depression years, and which led country after country to adopt measures which interfered with the free flow of international trade. Exchange controls, import quotas, multiple currency rates designed to promote exports and to restrict imports, bilateral arrangements which had as their chief purpose channeling trade between the countries party to the arrangement, and empire preferences, were among the restrictive and frequently discriminatory measures adopted. All tended to limit the foreign trade of the United States, which is heavily dependent upon multilateral trade - that is, trade which requires many-sided transactions for its final adjustment. Much of our export trade in past years was with countries from which we did not import an equivalent amount of goods and services. Much of our import trade was with countries which did not buy an equivalent amount of goods and services from us.

These restrictions on international trade were intensified during the war, not only by the physical diversion of production and shipping to war purposes, but also by the financial necessities of war-distorted trade. Great Britain, for example, was forced to adopt severe restrictive measures. In order to obtain essential materials of war she had to resort to strict limitations on imports, stimulation of uneconomic home production, large scale liquidation of her foreign investments, and such devices as the "dollar pool". Under the pool arrangement, countries in the so-called sterling areas turned into the common pool (against payment in blocked sterling) the dollars which they received for goods and services sold to the United States. They left it to Great Britain to decide what amounts of dollars would be allotted to them, to pay for a minimum volume of essential imports, and what amounts were to be used by Great Britain in defraying some of the costs of war against the common enemy.

To untangle even a part of this network of restraints on the free flow of trade, it is essential that Great Britain, one of the great trading nations of the world, be aided back toward something like her free trade policies of former years. She cannot begin to reverse the trend without our help. Her war-born debts to other countries are vastly in excess of her immediate means of paying them. Many of her foreign investments, which formerly were a source of overseas income, have been sold. Her industries have to be reconverted from their wartime uses, and her manpower redistributed in a peacetime pattern of employment. Much energy, in these immediate postwar years, will have to be devoted to reconstruction or repair of war-torn areas. In these circumstances, continuance of severe restrictions on her foreign trade would be inescapable. With financial aid from us and others - Canada has already agreed to extend a credit to Great Britain which is proportionately much larger than the United States credit - these restrictions and restraints can be somewhat relaxed.

It is clearly in our interest, it seems to me, that there be the widest degree of freedom in world trade, so that multilateral exchanges of goods and services may take place with a minimum of restriction and restraint, and with a minimum
of discrimination as between nations. That is the kind of trade to which our economy is supposed to be geared, and that is the kind of trade which permits the most efficient and effective use of the world's resources of men and materials. Without our financial help in this period of transition from war to peace, Great Britain could not join us in this world enterprise. With our financial help, generously given, she will be able to do so.

It will not be an easy undertaking. There are those in Great Britain, competent to assess her position, who believe that this is an attempt to set back the clock; to restore a kind of trading world to which the British international position is no longer adapted. Certainly it will become less and less possible if the United States is prey to periods of severe inflation and deflation, or if we are unable to find a balanced international position. In the years between the wars we were intermittent and somewhat capricious lenders abroad, and we found no good answer to our tendency to be a creditor on both current and capital account, at one and the same time. We have commonly thought in terms of fostering exports and repelling imports. To reverse that process is not simple. There are difficult adjustments to be made here as well as in Great Britain, if this proposed world of multilateral trade is to be more than an economist's blueprint.

To try to attain it, however, is to make a contribution to world peace which we cannot afford to forego. The times are too uncertain, the portents too oppressive. World peace is the goal and the only international goal which has any relevance in this new atomic age. If attainment of the goal requires, among other things, that a strong, economically healthy Britain press forward at our side, and I think it does, then the risks which may attach themselves to these agreements are small risks to take.

But even if these broader considerations be ignored or minimized, I still fail to see how a Congress which adopted the Bretton Woods plans by substantial majorities, could fail to approve the Anglo-American Agreements. Without our financial aid to Britain her participation in the International Monetary Fund becomes either impossible, or a sham and a pretense; and without participation in the International Monetary Fund, she would not be eligible to participate in the World Bank. These things should have been clear when the Bretton Woods program was adopted, and they should be clearer now. It seems to me to be a sort of political anarchy in the field of international economic relations, to join in setting up international institutions of high purpose and fair promise, and then to help make it impossible for them to work.

I feel this the more keenly, because of another and even more ominous shadow which hangs over everything we do and everything we say in these revolutionary times. In a world which is groping toward some means of international control of atomic energy, time is short. Fumbling delay and diplomatic maneuver are as obsolete as man himself is said to be. Yet the international scene is becoming painfully reminiscent of the spectacle which followed the last war, pitiful as that performance now appears. It is as if old actors were spouting old lines on a stage which is about to be blown into eternity. That might be all right if your taste runs to the gruesome, but unfortunately we, the audience, will also be blown to bits in the process. The complacent may comfort themselves by reflecting that man has survived the invention of a whole series of death-dealing weapons. But the atomic bomb is no blunderbuss replacing the bow and arrow - it is a revolutionary development. Unless we prevent wars there will be no ultimate protection against its destructive use. And unless we, and other countries, revolutionize our dealing with international affairs, we are not going to prevent wars. It would be a tragedy - indeed, the final tragedy - if the hope and promise which lies in the constructive exploitation of atomic energy were lost in senseless battle.

In the words of Emerson, these are times "when the energies of all men are searched by fear and by hope." It will be a good time to have lived if our hopes confound our fears.