

WAR AND THE NATION'S FINANCIAL STRUCTURE

Address

By

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Somebody once remarked that the reason a speaker is assigned a topic is to give him something to wander away from. I'll get to the subject before I get through, but I want to approach it as part of a consideration of the values that guide our behavior as men and as a nation.

Every individual has his own standard of what is worth-while. It is shifting all the time, partly because he himself is changing, and in part because his conception of the world in which he lives is changing. It is the composite of these individual standards of value that govern the national course of a democracy.

Most of us have experienced a radical and thoroughgoing change in our standard of value in the past two years. An earthquake that shook the physical world in which we live would scarcely have been more cataclysmic.

I think we all realize that we have passed the time when we in the United States can afford to cherish, pet, and gratify any values that fail to meet a few fundamental tests. This is true of us as individuals; it is true of us as a nation.

In the category of primary values on which we must now concentrate as individuals and as a people I would list only three.

Predominant above all else are the infinitely numerous acts which make up the united effort of the nation to win this war decisively and at the earliest possible moment. In a terribly literal sense, nothing else counts; nothing else can be permitted to count if it is out of step with that objective.

But close behind and, in a sense, a part of the drive toward that primary goal, is the necessity to maintain a domestic order that is worth fighting for, that is worth coming back to when the conflict abates, a society founded on the dignity of the individual and maintained through the institutions and efforts of free men.

The final and much less tangible task of primary value is harder to define, but it is enormously important. Let's call it the development of a sense of perspective - a definition of the ultimate goal. We aren't fighting this war to restore the old order in Europe or to maintain the British Empire in the East. We are in a world-wide revolution, the outcome of which will determine whether our children's sons will have to bear arms and face death as yours and mine are doing today in a struggle not of their making.

We faced that responsibility once before, and faltered at the finish. We cannot make that mistake again. That is why I place the realization and the acceptance of our long-time responsibility on the same level as fighting the war, and keeping citizenship sound behind the lines.

I have to fight the temptation to use more time than appropriate in talking about the nature of this war, and the strain which developments of 1942 are likely to throw on our spirits and hearts right here in Kansas. We are battling an enemy which practices total war while we still only talk it; who has spent years of complete national effort in preparing for a test which we have only months to get ready to meet.

I want to repeat what has been said many times - we can't win this war as a side show to our normal lives, and we can lose it unless we throw every ounce of strength in our national fiber back of the boys out there in thin lines on land and sea. Those soldiers and sailors are the protectors of the greatest industrial nation on earth, but they still have to contend with overwhelmingly superior mechanical equipment on the other side.

Some of you heard Don Nelson say the other night that this is no time for easy optimism; that one gun, or one tank, or one plane this spring will be worth ten next year. Those weren't idle words; he meant what he said. He gets his sense

of values right out of the nerve center.

We have talked a lot about all-out mobilization for war but we haven't understood the words. Generally, we are unconscious victims of a belief in our own invincibility; a conviction that we can lick the world with one hand tied behind us. We have been slow to realize that one loaded machine gun has far greater power in an immediate test of strength than a whole range of mountains filled with iron and copper ore. It is hard to grasp that a nation which has all the gold in the world can be beaten by a nation that hasn't a pound of it. All of us in some degree have been going a long in the belief that, while some sacrifices are necessary, it is the other fellow who ought to make them. We want to win the war comfortably with our future secure and our old privileges and immunities untouched.

It cannot be done that way. This is a desperate life-or-death war in which the outcome is by no means certain. The sooner we realize that there is a chance for us to lose it, the sooner we will be able to do the things necessary to win it. It will be a hard war that will last a long time. The length of the military struggle will be in the inverse ratio to the speed and thoroughness with which we devote our whole national energy to producing for and prosecuting the war.

Many of the old values which you as bankers and as community leaders have cherished in the past must now be filed away for the duration of the war. Some of them will never be brought back. How well we all discharge our responsibilities in the trying days ahead depends in no small part on how successfully we adapt our sense of values to the actual condition of our nation in this, the most desperate crisis of its history.

We can't all of us serve in the Army and Navy. We can't all work in the war factories. All of us cannot leave our own responsibilities for administrative posts in the government. But there are many things we can do.

Apart from the responsibilities we bear in common with all citizens, bankers have special and essential duties to perform. You are all key officers in the first total mobilization we have ever attempted in this country. I want to discuss a few such duties here today, emphasizing the point of view that these must have first place in our set of primary values. I shall talk about the special responsibility and opportunity banks have today to finance expanded war production; about our task as star salesmen and issuing agents for the War bonds sold to our citizenry; about some other problems related to financing the war; about the bankers' part in the fight against inflation; and, finally, about your general responsibility, as leaders of thought and public opinion in your communities, to promote a better understanding not only of the fiscal problems and policies of the nation, but of the broad underlying nature of this gigantic struggle which will determine the future course of the entire world.

The leaders of this nation realized early that we could only reach maximum war production if the manpower, the natural resources and the plants of all parts of the country were put to work. This state is an excellent example of how the program has been carried out. Although Kansas ranked low in manufacturing in the past, the state had plenty of room for expansion of industrial facilities and large supplies of unused manpower. These human and natural resources, the central location of the state, and its excellent transportation have brought a number of war production plants here including large facilities for the production of the planes so vitally needed in this war. According to a recent tabulation, Kansas had been awarded nearly \$800,000,000 of prime war supply and facility contracts from June, 1940 through February, 1942. Kansas is rapidly becoming an arsenal and in common with other states will be called upon to shoulder a much heavier production load in the future.

This must be done while men and boys, literally millions of them, are being drawn from production work. Our first assignment in the spring of 1940 was to arm and equip and train an army of 1,200,000 men. If this summer goes badly, we are likely to see ten times that number needed to do the job before the war is over.

After overcoming great difficulties, the production effort of this nation has now shifted into high gear. Recent achievements in stepping up aircraft and tank production are evidences of what can be done when we devote all our energies to the primary task of winning the war. In December the President's program seemed almost fantastically large, both in terms of war goods and in expenditures which were estimated at \$56 billion for the fiscal year ending June 30, 1943. Within the past two weeks the Budget Director has announced that expenditures are now expected to total \$70 billion, or an increase of 25 per cent over the January estimate. In order to reach such war production goals during the coming year, a substantial amount of the armament and equipment must be turned out by contractors and subcontractors, mostly smaller, whose facilities have not yet been put to work.

Obtaining this additional production is primarily the job of the Army and Navy procurement offices and the War Production Board. It will raise the problem of financing contracts awarded to these new concerns. Many cannot be financed in normal and usual ways. Many which are now borrowing or have access to a sufficient supply of credit to meet their working capital needs for limited output will be called on to produce many times the volume their resources would ordinarily justify them in undertaking.

The War Department, Navy Department, and Maritime Commission have decided that this financing program should use the facilities of the banks to the fullest extent possible. Most of you know that these agencies of the government have authorized the Federal Reserve banks to act as their agents in arranging guarantees

for banks where special provisions are necessary to enable them to finance their customers in production needed for the war.

Thus, as a primary task, banks and other financing institutions are now given a real opportunity to assist the war effort directly. A great new responsibility is put up to the commercial banking and financing system. Let me elaborate on these two aspects of the program.

First, with regard to the opportunity of the banks. The transformation to a war economy means that the regular activities of private business will be drastically curtailed. Normal credit needs for carrying on this business will diminish. During the first few weeks industrial and commercial loans of the reporting member banks in the principal cities of the country have shown a substantial decline. In Kansas total loans and discounts of all member banks of the Federal Reserve System showed a 5% decline from the end of 1941 to April 4 of this year. Kansas seems to be relatively better off with regard to declining loans than many other sections of the country. For loans actually declined more from the end of 1940 to April 4, 1941 than they did from the end of 1941 to April 4, 1942. However, as the war effort expands and normal business shrinks, loan liquidation may continue at a greater rate. Inventories which are still large will be liquidated, and depreciation reserves will accumulate in cash, since replacements in plant and equipment cannot be made because war demands all of the machine output. Consumer credit, which is largely based upon sales of durable goods, is rapidly disappearing from the credit picture. The only way banks can maintain their loan volume in these circumstances will be to finance customers who need to borrow for war production.

Second, the program places new responsibilities on the banks. The fundamental reason why the armed services and the Maritime Commission wanted banks to handle the financing of war production contracts is because the banks can service

the loans more adequately than if they were made directly by the government. It is for this reason that a maximum interest rate of 5 per cent is permitted when the government itself can borrow money at  $2\frac{1}{2}$  per cent even on long term. If the banks do not meet this responsibility, financing to produce needed war goods will be arranged directly by the government.

I believe the banks will accept this challenge. It will call for some changes in our standards of value. Bankers cannot afford to look at these loans in terms of normal credit risk, or shy away from them because they mean more work. Whenever a bank is approached by a customer to finance a war production contract, it becomes the duty of the bank to see that the financing is arranged in one way or another. It is our duty in the Federal Reserve, and the duty of the R.F.C., to assist you. There is room for all of us in this great and growing task. Work on war contracts must not be delayed or impeded by lack of financing.

If banks wholeheartedly take hold of these war production loans, the job of production will not lag through lack of financing. No doubt many of these loans required by your customers can be made without resort to the government guarantees. If the risk is greater than a bank can prudently assume, the Federal Reserve bank stands ready to work out a satisfactory guarantee, provided the government has certified that the production is needed for the war. The amount of the guarantee and the safeguards that may be necessary will have to be worked out according to the circumstances of a particular case.

Now just a word about your work with War Savings bonds. Commercial banks are performing a patriotic service as selling and issuing agents. The bankers of Kansas deserve a merit badge - 95 per cent of the 653 banks of the state have qualified to issue the Series E War bonds. It is true that a few of these banks haven't ordered any bonds yet, but they are all lined up and most of them are working at the job.



I heard a man say the other day: "The banks must be making money these days - look at all the government bonds they are selling." This is the wrong sort of audience before which to answer such a rumor, because you know well enough that it is a willing and a free patriotic service you are giving at financial cost to your own institutions - and you are happy to do this work and push it hard as part of our war.

We are not selling as many of these bonds today as we should - not nearly enough. I predict that unless the public enormously increases its voluntary purchases, sooner or later a system of compulsory purchase from current income must inevitably be adopted. We are going to have to raise our sights.

An intensified campaign for the sale of War Savings bonds began on May 1. A quota of \$600,000,000 has been set for the month of May for purchases of War bonds in the United States. Kansas' share in this quota is \$4,617,000. In July the quota for the country as a whole will be raised to \$1,000,000,000 and if the Kansas proportion of this quota is the same as it is of the \$600,000,000 quota, Kansas' share of purchases in July and for each of the months following will be about \$7,750,000. Thus during the fiscal year 1943 Kansas will be expected to purchase about \$93,000,000 of War bonds which will represent approximately 8 per cent of the state's income in that period. However, the War bond program should be met in this state without too much trouble. Purchases of "E" bonds alone in Kansas in January were almost \$6,000,000 and in February almost \$4,600,000. Actually for the first two months of this year people in Kansas were buying bonds of all series at a rate approximating \$100,000,000 a year, so that if this rate is maintained Kansas will go over the top on its quota. Since the United States as a whole for the first two months of this year was buying bonds at a rate somewhat less than its quota for fiscal year 1943, Kansas already has a head start on the rest of the nation.

These are concrete, tangible things banks can do and are doing. In addition, bankers have a heavy part to carry in the fight now launched to prevent a headlong plunge toward disastrous inflation. Let us consider a few basic truths.

We are going to have to reduce our standards of living while this war is on. We're going to buy less, eat and entertain more simply, wear the old suits longer, because we're making planes and tanks, guns and equipment, and ships to carry them in, instead of all the things our pampered bodies have craved and grown accustomed to. If we all try to buy as much as we did in the past, to live as well, this country will go down one or two roads. Either we'll be forced to accept iron-clad, universal, dictated rationing, or we'll head into an inflationary tornado that could wreck the economy.

The national income is going up. It cannot help rising. A large part will be put in War bonds. Part of it will be given in generous donations to keep the social body at home sound and worth fighting for. And most of the rest of it will be spent. But let me say with all the emphasis I can command - the less we spend on ourselves in these trying days, the better it will be for our country, and for ourselves in the long run.

Let me put that another way. Even if we paid no taxes, bought no bonds, and donated nothing to worthy causes, we still wouldn't be able to buy with our money the goods and services that go to make up our old standard of living. They will not be available.

The commercial banks are going to be called on to do a substantial part of the heavy government financing that is ahead of us. This raises many problems, including that of interest rates, the adequacy of bank reserves, and the general effect of the enormous public debt upon the nation's economy. I can only touch these points briefly.

It seems to me that recent history and present conditions have already determined the general range of interest rates that will be followed. Rates on outstanding War Savings bonds and on recent open market issues cannot be departed from too far in succeeding financings. The reasons for this are fairly obvious. A rising tendency in rates encourages investors to hold off with the idea of obtaining more favorable terms in the future. It might also lead to cashing by the public of a substantial amount of the present outstanding savings bonds.

Moreover, it should be remembered that banks and financial institutions have more or less of a vested interest in the maintenance of the existing rate pattern. At the present time bank portfolios contain some 20 billions of government securities. If rates on new long-term issues should increase very much these outstanding issues would drop sharply in price with unwelcome consequences on present bank holdings. Finally, in view of the controls which have been placed on many phases of our economic life, it is hardly likely that fluctuations in the cost of money to the government will be left entirely to the vagaries of the market.

I hope these remarks will not be interpreted to mean that there can be no change at all in the interest rates. In recent months we have seen a considerable firming of short-term rates. Short-term rates before were artificially low in relation to long-term rates and are now in better adjustment.

In view of the dependence upon banks to finance an important part of the war program, it will be necessary to assure that bank reserves are always adequate for this purpose. The Board of Governors of the Federal Reserve System announced at the outbreak of war that the maintenance of adequate reserves would be one of the keystones of Federal Reserve policy during the war. This does not mean that banks will necessarily have as high a volume of excess reserves as they were accustomed to have in the recent past. The war effort in England has been financed

without any excess reserves at all. In view of the different character of the American banking system, involving some 15,000 individual banks, the continued existence of some excess reserves would seem to be necessary here.

There are several ways in which Federal Authorities can move to increase banking reserves. One, obviously, is to modify reserve requirements. Another is through Federal Reserve open market purchases. As Chairman Eccles observed the other day when meeting with a Congressional Committee, the resources of the Federal Reserve System for that purpose are practically unlimited. Individual banks can increase reserves to meet temporary demands by borrowing from the Federal Reserve.

Thus far I have talked to you as bankers faced with the immediate job of doing your part in financing the war. While we are doing that, we had better be looking through and beyond this immediate task in order that, after winning the war, we may not lose the peace, either at home or abroad.

I have a great deal of sympathy for the man who looks back longingly upon America's pioneering days when we had physical frontiers to develop, and hopes for their return. There were many problems we didn't have to face and could postpone in those days when the jobless and the overcrowded could move out and take up free land and when the outside world was ready and eager to buy all the raw materials we could produce, providing us with capital in return. We have gone far from that condition in the past two decades, and we will be farther away still when this war ends.

The world that emerges will be totally unlike the world we have known. But the challenge of a frontier still confronts us if we will only see and rise to meet it - a challenge more stupendous, more breath-taking, than any that faced our forefathers.

There is only one assumption for us to make as we look forward to the end of the war - we are going to win it. We will emerge, as I have said repeatedly, with the finest mechanical plant and the greatest army of skilled producers we have ever had, and with our natural resources unimpaired. We will also have incurred an enormous national debt. Let us be realistic about it; the size of that debt will be an academic matter if we should lose this war. But it is only natural that men who have spent their lives in financial service should feel grave concern as to its ultimate size.

On June 30, 1940, the national debt stood at slightly over \$40 billions. By June 30, 1943, it is estimated the debt will increase to \$125 billions. Notwithstanding the government's effort to cover the costs of war so far as possible with current revenues, the debt may go far beyond that amount before the war is over.

No one likes the prospect of a public debt of such magnitude, but this isn't a question of likes and dislikes. We are in this war, and the debt has become nearly an inevitable fact. The question, therefore, is what we are going to do about it.

Americans are not defeatists by nature. On the whole, we have been incurable optimists. This is no time to change. Let us then look at this problem of the public debt with confidence that it does not mean the end of America or of the American way of doing things.

On the positive side, we note these factors: The bonds will be held by citizens of this country. Service payments raised by taxes from one generation will be paid to the same generation. It will be an internal debt, so we avoid the impossible task of transfer which accompanies large external debt. We will end the war with a high tax structure, capable of yielding enormous revenues if national production and national income are maintained.

The challenge, the new frontier at home, therefore, is this question of learning how to use our resources and our manpower in full production when the war ends. There isn't any dodging the issue. Democracy, here or abroad, must meet and solve it in order to survive. If we meet it successfully, then we will be able to go forward whether the public debt is big or little. If we fail, it will not be the size of the national debt that defeats us; it will be because we haven't been able to provide continuous employment and full production.

That is the new frontier at home. The field of our international relations confronts us with a frontier so vast, so unexplored, that many of us haven't even begun to realize that it exists. It is so enormous I can only hint at it today. I merely want to state, quite baldly, my personal conviction that if we want a world in which the children of our sons and daughters can dwell in peace and freedom, we must plan now for an effective union of the right-thinking and peace-loving nations of the world in which we will unfalteringly play our part. The task is no greater than that which 13 struggling little states undertook one hundred and fifty-five years ago.

This isn't just a war in the sense of past wars. It is a world-wide revolution. We believe that democracies embodying the institutions of human freedom can guide that world revolution better than can dictatorships that deny freedom. But the challenge is breath-taking. In the long run future democratic leadership cannot meet it unless it performs better than it has done in the past. It cannot meet the challenge if it is content to rest on the efforts and the devices of the past which have produced the paradox of scarcity and want where the materials and the opportunity for abundance exist.

These are the responsibilities that confront the democracies today. The people of the United States must understand the implications of the world crisis

and they must see clearly the consequences of our own behavior. Without that common, general understanding, leadership will be powerless to deal with the tremendous difficulties that are ahead.

In conclusion, let me point out that the men in this room today represent more than mere agencies in the nation's money and credit mechanism, as important as they are. You as individuals are a vital power in forming the public opinion of the United States. In the aggregate, your influence is enormous. I do not expect you to agree with all the implications or conclusions of my remarks. I do ask you to think about the problems I have tried to spread before you. No one has all the answers; no one can now prescribe in full the course we should follow.

We must face the future with courage and with understanding. We must rest our faith on the conviction that freedom and the dignity of individual man will survive and we must be willing to fight to make that come true. In that spirit lies the hope that today's pain and struggle may be made only a phase in the evolution of a safer and better world - one in which freedom of thought and the institutions of human freedom have survived.

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