ARKANSAS AND THE DEFENSE PROGRAM

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I am sure you all realize that when a speaker selects a name for a speech some weeks in advance of its delivery, he tries his best to pick a title which will give him maximum freedom and permit him to talk about almost anything appropriate when speech time rolls around. So, when I was asked for a title for my talk to you today, I put down "Arkansas and the Defense Program", which certainly is broad enough and still seems appropriate. I am going to talk about Arkansas and about the defense program, but I also want to discuss the banker's role in our national defense effort.

When I began to put together some material for this talk, I found my thoughts returning time after time to the 38th parallel of north latitude, that globe-encircling imaginary line almost half way between the Equator and the North Pole. You see, that line intersects three places occupying prominent positions in my book of memories and experiences. Thinking about those places brought home to me in most vivid form the degree of interdependence which exists in this world of ours and the fact that events thousands of miles away affect people right here at home and in many distant places.

Probably few of you Arkansas bankers thought much about the 38th parallel until late last June when news was received that the red hordes of North Korea had swept across that arbitrary boundary and had invaded South Korea. As soon as that action took place, however, this hitherto obscure line on the map became the focus of the apprehensive attention of many people in many nations.

In the United States, whose international position and strength automatically gave it leadership among the United Nations in the task of checking North Korean aggression, the 38th parallel became a byword. American soldiers were killed and wounded on the 38th parallel and on both sides of it. So were the soldiers of other nations of the free world. Our forces moved north across the parallel as the Red invaders were driven back. With Chinese communist intervention in November, we were pushed south of the line. For months bitter fighting has been occurring right on the parallel or just off it. Thus, ever since that fateful day in late June, 1950, the 38th parallel of north latitude has held the spotlight of men's attention in this distraught and troubled world.

Now follow me westward from Korea approximately one-third of the way around the world to another little country also intersected by the 38th parallel and also acquainted with the grief resulting from war and foreign invasion. I speak now of Greece, a nation studded with the relics of an ancient and glorious civilization from which stems so much of the culture of our western world. In June, 1950, I was in Greece, and it was there I had the first news of the North Korean invasion. After a short visit back home, I again was in Greece when the news of Chinese intervention in Korea came in late November. I shall never forget the anxiety and distress written on the faces of my Greek friends and colleagues. I shall never forget the question on every Greek tongue: "Is this it? Is this the beginning of another global war?"

I shall never forget how the Greeks, with their painful memories of a recent astronomical war-induced monetary inflation, reacted to their new fear that another war was in the making. Within a few days after Red China intervened in Korea, the Greeks converted some 8 per cent or more of their circulating currency into gold sovereigns, a significant flight from their own currency, the drachma. I assure you it is a terrifying thing to witness the antics of a panic-stricken people who have no faith in their money, who have no faith in their banks, not because they distrust their banks as institutions or their bankers as businessmen, but because they distrust their own money which is the stock in trade of their banks and bankers.

It is terrifying, I say, to witness such a panic and yet it was an understandable panic. The Greeks had had a recent painful experience with inflation and its evils, and memories of this experience were fresh. World War II and the German occupation had resulted in tremendous price inflation. In an attempt to correct the ill-balance between money and goods, the Greeks in November, 1944, instituted, by decree, a new series of currency for which the old currency was required to be exchanged. The rate of exchange was 50 billion old drachma for one new one. Anyone who has witnessed the aftermath of such an inflation feels a strong surge of pity and sympathy for its hapless victims and understands the basis for the Greeks' gold panic of 1950. And one also becomes possessed of a firm resolve that no such thing and nothing remotely resembling it shall ever be permitted to happen in our own land.

Now let us return to the 38th parallel and follow it westward again - to my native hills of Missouri only a few miles south of St. Louis - to my home town of Farmington in St. Francois County. Farmington, like Athens and like Seoul, is located near the 38th parallel. In that sense Farmington, Athens and Seoul may be viewed as neighbors. And actually in the larger sense they are neighbors in the world community, and as the world grows smaller they become closer neighbors. Close neighbors in an interdependent world community are bound to be affected by events in that community; actions by or against one neighbor are bound to have some effect on the other neighbors. One day it is my earnest hope, and I am sure it is yours, that all actions will be truly neighborly and the nations of the world will be able to live together in a community dedicated to peace.

My story of three locations along the 38th parallel then points to the conclusion that Farmington, Missouri, was affected by events in Seoul, Korea, just as Athens, Greece, was affected by these same events. As a matter of fact, although the people of Farmington probably did not recognize it, they had felt repercussions of actions along the 38th parallel long before June, 1950. To go back only ten years, the effects of Nazi German and allied action in Greece in World War II had repercussions in Farmington. So had the postwar relief and rehabilitation programs in both Greece and Korea. So had the establishment of the 38th parallel as the boundary between North and South Korea. So had Greek military aid and the guerrilla campaigns in Greece. June, 1950, merely made the effect more noticeable.

What is true of Farmington is also true of Arkansas. You people of Arkansas also had been affected by developments abroad long before June, 1950. But the North Korean invasion drove home the realization of those effects. It also resulted in a major change in United States armament policy, a change which is affecting you now and probably will affect you more strongly in the future.

Some of the effects of the defense program so far can be seen in physical terms right here in Arkansas. There are many more uniforms to be seen. Camp Chaffee has been reactivated. The big navy rocket plant at Camden is operating and moving toward full-scale production. Alcoa is coming back to Arkansas with a new alumina plant at Bauxite. General Motors is building a new aluminum fabricating plant at Jones Mill. A lot of construction is going on or will begin shortly.

Not quite so easily seen as soldiers army camps and new plants, but still very tangible, are the defense contracts going to Arkansas businesses. So far the amount of direct contracts placed with private Arkansas firms has not been large, but subcontract work and work done at Government-owned plants would swell this total appreciably. As the defense program proceeds, the volume of such work will increase considerably; and whether or not the work shows up in the contract statistics, it does show up in increased employment and increased factory payrolls.

There are more people working in Arkansas today than there were at this time last year. Total nonfarm employment in the state was about 305,000 in March, some 22,000 more than a year ago. Seventy-eight thousand of these people were working in manufacturing plants in March, 8,000 more than a year ago, and more than double the number of Arkansas factory workers before World War II.

The effect of the defense program is not confined to industry alone. Farmers are aware of its impact, since the requirements for farm products call for heavy agricultural production. Acreage goals are much higher this year than last, when actual restrictions were in effect. Demand for farm products has pushed up farm prices and will lead to more farm income to go along with increases in industrial payrolls.

You bankers know that the increased demand for goods of all types, both civilian and military, has had an impact on your business. Loans are up substantially and deposits in Arkansas banks are now about $50 million larger than last June.

Finally, prices have risen sharply here, as elsewhere, and, as the defense program proceeds, pressure on prices seems likely to mount rather than diminish. I imagine that all of you bankers are aware of price increases - if you are not, I am sure that your wives are. I want to talk more about this point later.

In summary, then, you people of Arkansas are feeling the impact of events taking place elsewhere in the world. I expect you will feel that impact for a long time and will feel it with increasing strength.

Here I want to make a point which I believe is of key importance. The requirements of the defense program are set high and will be hard to meet. We will meet them, of course, even though it will not be easy to do so. The important things to consider are the means we employ to reach our goal.

It is reasonable to believe that the defense effort will continue for a long time. If we avoid full-scale global war, which I pray we can, we seem likely to be in for a long period of becoming strong and staying strong. We are in for what has been aptly termed a period of "armed alert" which has no known terminal date. It may last for five, ten or twenty years - or longer. All we can count on realistically is an indefinite period of tension, of defense build-up and maintenance.

The key factor in such a program is a strong and resilient economy. It requires wise use of our resources not only to become strong but to remain strong. Each segment of the national economy must contribute to the growth of national strength and at the same time do so without impairing its long-run potential.

Here in Arkansas you have been engaged, and successfully engaged, in an attempt to build up your state's economy through wiser and more efficient use of your resources. Arkansas has become widely known as a state in which government, business, banking, the professions, agriculture and individuals have worked together to improve productivity and income. The Arkansas Plan, which envisages the cooperation of all these groups, has produced excellent results so far.

What you have been doing is what economists call regional economic development. You have attempted to use the resources you have at hand - your land, your labor and your capital - to provide a better economic balance in the state. You have sought a better economic "mix" of these factors of production, and you have done a good job.

It is most important that you continue to do a good job in this respect. As I said earlier, a defense program without terminal date requires the wisest use of resources that can be obtained. You will do yourselves and the nation as a whole no favors if you unwisely exploit your resources and thus weaken the economy of Arkansas over the long pull.

It is vital to the interests of the nation that Arkansas build a strong economy and keep it strong. That coincides with your own direct interests. So you should, in so far as you can, continue on your path of regional development.

You should continue to seek a better economic balance in your own state.

I would not confine this recommendation to industry alone. Arkansas is a farm state and its farm products make an important contribution to national strength. It is vital to recognize that agriculture's long-run strength should not be jeopardized by exploitive farming.

Let me make one other point in this connection. There is a great potential labor surplus on Arkansas farms, and that surplus could be made available for further industrialization, both in the immediate and in the long-run future, if farm productivity could be improved. Now you and I know that right at this moment farmers are looking desperately for farm workers, and I certainly do not mean to imply that there are a lot of surplus farm workers running around loose. The point I wish to make is that, as you increase farm mechanization, as you improve the use of the basic agricultural resource - the land - productivity per man on the farm will rise sharply. Thus you can have a better balanced and a stronger agriculture in Arkansas and at the same time automatically acquire a pool of available labor for further industrialization. It seems to me that regional development of this kind would be sound policy for Arkansas and would at the same time make a valuable contribution to the defense effort.

There is another point of great importance to the problem of successfully mounting and maintaining a strong defense program during a long period of "armed alert". Unless we are able to hold down the forces of inflation, we will place the whole defense effort in jeopardy - at best we will make it far more difficult to attain our goals.

You all know what mild inflation is - you have lived with the problem for the past decade. But you may have only a hazy idea of what really bad inflation can do to a nation. I referred a while ago to my own observations in Greece. While Greece is an extreme case, crippling inflation has occurred in many other countries. We cannot, we must not, allow it to occur here.

The basic fact about inflation is that it is caused by an imbalance between purchasing power and available goods. When the supply of purchasing power increases faster than the available supply of goods, upward pressure on prices develops. Then follows rapid changes in prices, with considerable variation in those changes as far as different items or goods are concerned; then accompanying rapid changes in both real and money incomes; then changes in demand-supply relationships and variations from previous patterns of such relationships.

The bad fact about inflation is not that it causes price rises and other symptoms as such, but that these results bring about distortions in the economy and cause it to operate with less efficiency.

Let me draw an analogy here between the economy and an engine. The national economy may be viewed as an engine which uses money and credit as its power supply or fuel. The supply of fuel should flow into the engine in such volume as to keep it operating at full efficiency. If it is either more or less than meeded, the engine falters. In economic terms, too little fuel means deflation; too much means inflation. And the basic reason for trying to keep the economic engine in balance is simply that it operates most efficiently that way.

As the staff of the Joint Committee on the Economic Report recently put it: "Inflation corrodes production incentives, makes 'suckers' of savers, inflicts arbitrary hardships on those receiving fixed incomes, and generates the kind of social injustice and social unrest in which the propaganda of communism is most successful."

This would be bad enough if the problem were purely domestic. But at present we face this great international emergency. We have to keep operating efficiently in order to survive. The importance of a stable economy is far greater now than it would be in a period of relative international quiet.

Inflation not only impairs the efficiency with which we operate at a critical time; it increases the cost of our whole defense production effort. Prices of goods used for rearming have gone up tremendously. All of you have read reports about the steadily shrinking purchasing power of the defense dollar. The Joint Committee's report released a few weeks ago pointed out that galloping inflation has knocked a lot of military airplanes out of the sky just as surely as enemy anti-aircraft fire might have done.

I spoke earlier of the fact that the basis for inflation is a change in the relationship of the supply of purchasing power to the available supply of goods. Theoretically, if that relationship changes, it can be brought back into balance either by working on the supply of purchasing power, or on the supply of available goods, or on both sides of the equation. Practically speaking, at the present time and under present conditions there are no immediate prospects for working effectively on the goods side of the equation. We are using just about everything we can make and we are making just about everything we can. If the defense program takes more and more goods away from the civilian economy, the imbalance on the goods side is likely to be accentuated rather than corrected, at least over the short-run future. Given time we can increase our productive capacity substantially, but that is a slow process. Therefore, from the practical standpoint we are now confronted by the necessity to work on the money side of the equation.

Purchasing power comes from three main sources; from current income, from the use of past savings, and from the increased use of credit. To reduce effective purchasing power it is necessary to carry out a many-sided program embracing increased taxes, reductions in Government and private spending, programs to promote savings, and restriction of growth in credit. I am going to talk about only one of these phases today, the credit phase. I want to make perfectly clear, however, that it is only one phase; but it is the major one in which bankers can make a significant contribution.

It is important to distinguish between three types of lenders; nonbank lenders, commercial banks and central banks. Nonbank lenders can lend or invest only the money they have received; as they lend, they transfer ownership of funds, but the transfer does not change the total amount of funds. Commercial banks, however, create new money when they lend or invest. As bankers, you know that when bank credit expands, bank deposits increase. This power of the commercial banks to create money arises from the fact that they have to keep only a fraction of their deposits in the form of reserves. Their ability to expand deposits, therefore, depends upon the amount of reserves available to them and the amount of reserves required to be kept against deposits.

The central banks - the Federal Reserve Banks - can make reserves more or less available to the commercial banks by their actions in buying or selling Government securities, or in lending directly to the banks. At present the Federal Reserve Banks are pursuing a restrictive policy with respect to reserves, that is attempting to make reserves less available to the commercial banks.

A restrictive monetary policy is a powerful force that can be brought to bear on inflation. Tight money can check a boom; it does so by causing the spending plans of individuals and businesses to be revised downward.

Note this point, however. A restrictive monetary policy on the part of the Federal Reserve System means freedom on the part of the System to buy and sell Government securities in the open market in the light of general credit conditions rather than for the sole purpose of conducting price-support operations in the market. If the System is to make reserves less available, it has to be in position to refuse to buy securities, and even to sell some. And that kind of action means fluctuating Government security prices and yields, not fixed prices and yields.

Here is another point that should have more widespread recognition. Restrictive action with respect to bank reserves leads to higher interest rates in the normal course of events. But higher interest rates as such are not the aim of a restrictive policy; they are merely the reflection of a restrictive policy. The primary fact to remember is that the banking system cannot expand credit and deposits without excess reserves. Central banking restriction works by refusing to supply the reserves. Tightness in reserves brings about tightness in the money supply and, as the demand-supply situation of money tightens, interest rates tend to rise. The rise in interest rates, however, is only a by-product and not the direct objective of central bank action.

Another thing I want to emphasize, somewhat parenthetically, is that Federal Reserve people do not believe higher interest rates have much effect by way of restraining borrowers. Higher rates do knock out a few marginal borrowers, but the bulk of borrowers are likely to continue their demands for credit even though the cost rises. In other words, in the case of most borrowers the cost of credit is a minor factor in relation to other costs.

Let me tell you why I am emphasizing these facts about the role of monetary policy in these times. All of you are aware of one major and significant truth about our American economic system: It is relatively free. We have and enjoy a high degree of individual freedom and choice. That very freedom of opportunity and choice is the important variable between our economic system and the economic system of many other countries. These are not merely words nor idle rhetoric. They describe the heart of the American system whose major reason for success is the fact that it is flexible and dynamic. It seems to me, incidentally, just good common sense to make every effort to preserve that kind of system.

Monetary policy, coupled with fiscal policy, furnishes a means of combating economic imbalance by merely setting some broad, general, and impersonal rules under which individual freedom and choice are preserved and the economy is left free to function flexibly and efficiently. The same cannot be said of certain harnesses of controls which invade the realm of individual freedom, limit individual choice, and introduce inflexibility and rigidity into the economy. Monetary policy, by reason of its very nature, therefore, helps preserve the kind of economic system we are used to and one that functions better than any other the world has ever seen.

Bankers can help and are helping significantly in the fight against inflation. They recognize the need to keep the total amount of credit from expanding further and the need to channel credit into productive and essential uses. This is not a new need, it is the banker's traditional function. It is only present in aggravated form at this particular time. To help bankers discharge that function most efficiently a program of voluntary credit restraint has been invoked, participated in by bankers and other lenders. That program, as Mr. Oliver S. Powell, Chairman of the National Voluntary Credit Restraint Committee, puts it, is the "enlistment of the collective horse sense of all kinds of lenders to sort out the kinds of credit which should have priority under today's conditions."

To the degree that bankers succeed in holding down total credit expansion and to the degree that they meet essential credit needs, they will make an invaluable contribution to the defense effort. The task thus set for bankers is not easy. Indeed, most important jobs are not easy. The whole defense program calls for hard work on everyone's part.

If we put forth the effort necessary to perform the hard work that has to be done, we will succeed, and our success will make this world a better place. It will make this old, shrinking world a place where our neighbors in Seoul, Korea, and Athens, Greece, can pursue peaceful and productive lives, as we desire to do and, God willing, will continue to do in these United States.

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