COLONEL JORDAN'S REMARKS INTRODUCING
Mr. ~~PROFESSOR~~ Fred ~~FRANK~~ GARLOCK
September 7, 1934

The lecturer this morning, Mr ~~Professor~~ Fred L. ~~Frank~~ Garlock is a senior Agricultural Economist in the Bureau of Agricultural Econom~~y~~ics in the Department of Agriculture. He was professor of economics in Iowa State College for six years and is a graduate of the University of Iowa and Columbia University.

I am very much impressed with one thing about Mr. Garlock, as I was about the speaker we had last but about which I neglected to remark. He also was an officer in the World War. Professor Garlock was an ensign in the Navy in the World War and when I looked at him this morning I was convinced that he must have made a statement to the recruiting officer just advancing his age a little bit. Otherwise, I do not see how he ever got into the service.

MONEY, CREDIT AND PRICES
by
Professor Frank Garlock
Agricultural Economist
September 7, 1934

Gentlemen: I am very happy to be herewith you today. Colonel Jordan has referred to my war experience, but like a good many others, I am inclined to exagerate that. I think perhaps I had better make the record clear. In the summer of 1918 I enlisted in the Naval Air Service and got my call about the first of July, and by the time I finished my ground school the Armistice was signed. I continued and got my wings and commission in March 1919, just in time to pack them up and take them home. I always state that I was an ensign in the Navy and a pilot, which I did technically become although I did not have the satifaction of holding the rank for any extended period in the service. One reason I think for my exaggeration is that I always look back to that period as one of pleasant contacts and very excellent experience. Many times I have wished I had stayed in that organization instead of going over to the side of money and banking. In one thing, however, money and banking and the Navy are similar - a good part of the time you are apt to be up in the air, and never more so than at the present time.

I have had considerable doubt in my mind as to the best way to take up this subject with you and since I was able to reach no very definite conclusion I thought it might be best to make a general statement and then throw the meeting open for discussion.

I think perhaps the best approach to an understanding of money and banking and the way they affect us is to go through the technicalities afidthe subject and think of them as constituting a mechanism (money, credit instruments and banking instruments) for integrating the other parts of the economic structure. As you know, our modern society is built upon a division of labor and highly spee cialized prōduction with the resultant exchange of products of one industrỹ or firm with those of another.

In the Service we have the Army, Navy and Marine Corps. Each of these Services is divided into subdivisions, and finally you get down to clerks and stenographers of various kinds in addition to the various branches such as Infantry, Artillery, Air Service, etc. If you were to consider what position you would be in if you had to trade a month's services for the many things you need in the course of a month - rent, food, clothing and entertainment, and you tried to make a direct trade of services for the things you needed, you would see what the money, credit and banking structure has done to ease our way of living. That is no exaggeration. We could not live as we do without the money, credit and banking structure. Historically, our money seems to have been a commodity that was in use. Many things have served as money - anything could - but it has got to be something thatpeople are willing to receive. So, after receiving your monthly pay check you should find that your difficulties are largely ended, because everybody is willing to receive your money. That is the way your money pays for exchange of services - for the things you need.

As we get into advanced forms of economic development, credit instruments almost entirely take the place of money. Looking at the money situation of the country you see that there is practically nothing that is not credit. Take your pennies, nickels, dimes and quarters, which are about the only coins we use now - these are all valued at a greater value than the metal in them is worth. Take bills - paper money - that is credit pure and simple. Take the checking accounts we have at the banks - those are credit, pure and simple, and by that I do not mean there is nothing behind them, I simply mean they are credit instruments - the things we use as money and think of as money.

So we have in America and in practically all of the advanced nations, almost entirely substituted credit instruments for money in our daily transactions. The thing that is known as our basic money is used only to back up and support the instruments that we actually use. For instance, in this country we have been on the gold standard, gold being the basic money. In 1929 we had a few hundred million dollars in gold coins in circulation, just enough to make the change we needed to have. Years ago we used to use silver dollars, or cartwheels as they were called, but we gave them up because they were so inconvenient to carry and substituted paper bills. We buy a great many things for which we could not possibly carry around enough coin and for which we cannot use bank checks, such as theatre tickets, lunches, transportation (and the transportation facilities will not take checks) - so our own choice in the matter has determined the type of credit - that is, paper money. Owing to their great convenience we have substituted the use of bank checks for the majority of our credit transactions. Practically all big transactions are settled by check. So, because of its convenience, this is the system we have built up to serve as our money system. It consists of our bank deposits - mainly for checking accounts, - our paper money, our subsidiary coin, and back of all that is the gold, and the proportions are indicated by a figure such as this: in 1929 we had roughly about a hundred million dollars in subsidiary coins; perhaps four or four and a half billions in paper money, and something around forty or forty-five billion dollars in bank deposits. Back of that whole credit money structure there was roughly four and a half billion dollars of actual gold. The basic money which we do not use at all as individuals is a reserve for this credit structure and the smallness of that reserve, when we compare it to the claims which are supposed to be considerable, affords us an explanation of where they money went. Adn we often wonder where it went. Instead of there being money, gold, behind the bank deposits, they are chiefly secured by claims known as bonds, notes and other credit instruments which others pay to the banks. Gold serves as a reserve for the whole for which we have set up certain precautions - for instance, paper money has been secured in this country during recent years by very nearly 100% gold and the bank deposits are figured at something around four or five times the gold. So, that is roughly what is called the money structure of the country.

~~Thisxmmmmy~~ We use this money to facilitate our daily transactions. If we consider a time or situation when the economic system is functioning fairly smoothly, when most able-bodied men are employed at wages that afford them a fairly good living, when industries are operating at fairly high capacity at profits that afford a livelihood for those who have invested in them, commodities are at levels sufficiently high to afford a living to producers, when the machine seems to work smoothly and everybody is getting along - some not so well but others better than they have a right to expect - in that situation the money, credit and banking structure is operating a good deal as to keep the thing going. People who purchased beyond their means for the moment may get a start and buy ahead of time on credit; they may float mortgages or bonds to construct homes or business, or put in a supply of goods to sell later. The system is composed of a gradual creation of new credits, largely through abnking institutions, and the extinction of old credits, so we have a flow of credit from producer to consumer and back again to the producer, which keeps the machine functioning by serving as a medium of exchange. That is why I describe the banking, credit and money structure as an instrument for integrating the various parts of the machine.

When the system is working fairly well there are several things that I might call to your attention. The first is that debt involves one of the largest and most democratic forms of economic planning we can find. You get your salary and spend it in such directions as you choose. Certain basic obligations have to be met with part of it. The way you spend the other part determines what goods and services can be produced. If we do not spend our money for them, and a lot of people do not, it will will not be profitabb to produce. You see that in the shift from buggy to automobile. People exercised their voice in the matter through their purchasing power, and so we have an economic plan which ~~mi~~cludes the growing use of the automobile and the decline of the buggy. This is a democratic the system.

As between goods the system becomes more difficult. We have the operation

system of planning under which a person decides what he wants to produce and how much of it. The character determines our economic production. The second feature is that this system becomes a means of telling when you are getting out of line. As an individual, if you spend more than you receive you soon come up against it, and you have to cut down. That shows your consumption is out of line with your production. There is no one in the community who knows whether or not you are exceeding your income, but your banking institutions can tell, and they tell in this way: if you are spending more than is received there is a flow of reserve funds from the bank and immediately the bankers have to put into operation some means of checking that flow. Ordinarily they do that by cutting down on our loans, and by cutting them down they reduce the volume of spending to bring the ~~xxx~~ amount into line. They have to protect themselves and that is one of the checks in the system.

As between goods the system becomes more difficult. We have the operation of what is known as the gold standard. Nobody has any idea whether this country is spending too much or too little in relation to the conditions elsewhere except by watching what is happening to the monetary reserves and I might say that the principle function of the gold reserve of a country like ours is to tell whether the country through its business relationships with other countries is on even keel. If you spend too much abroad - more than we are producing or sending to them, we are in a bad place. So the gold standard, while it was in operation, acted as an indicator of the position of any given country in its relation to the rest of the world. That was its chief function and the chief function of gold itself - so that this country or any other could change its ways and get itself in line.

When a country loses any substantial part of its gold supply it knows it has got to reduce its spending so that it will be producing more and spending elsewhere less, and the gold gives the indication whether or not that is necessary. Usually the central bank of the country, like the Federal Reserve of this country, the Bank of England, etc., undertakes the responsibility of directing the gold supply and see that measures are taken so that the trade relationships will be proper as compared with other countries. When the gold supply of the United States is falling down the central bank attempts to restrict spending by restricting extensions of credit, by selling securities in the market or reducing its discounts for other banking institutions, so there is a means of controlling that situation. It works veyy nicely when the country is running a fairly smooth course without any great disturbing elements, but in a time like the last few years of course it broke down. All the world is having to pull in its horns, so to speak - reduce credit, reduce production, tend to keep prices up, higher tariff and rationing of trade in order to keep the countries from buying too much from others.

In Germany we have all of these at the present. They will only send you a certain amount of exchanee. It is only possible to buy an amount equal to what is sold abroad, and in addition to that quotas have been set as to what can be shipped into Germany, no matter what price you offer or what quantity. That is to protect the German gold standard. They apparently do not want to go off the gold standard, although they are off, because if they did the German mark would fall and they would get into another spiral of inflation such as that of a few years ago.

One thing also I would like to call to your attention is that the money and banking system, acting as the integratorof the econom c system, can get out of kelter just as any other mechanism but it is not the only part of the system that does. There is a great tendency in some quarters to pick on the money and credit system as practically the sole reason we are in this terrible depression. I want to at least register my objection to that viewpoint because I feel it is plain enough that it is only one of the things. If we look at the condition of the world before the depression we can find plenty of reasons for it without looking very closely in the banking situation. We had that period of reconstruction in Europe when vast carloads of materials were shipped from this county in order to reconstruct after the war. The countries of Europe were spending beyond their incomes for the purpose of building up destroyed industries and that developed into a system of borrowing for things that could hardly be classified other than luxuries; better transportation facilities, better housing, and a great many projects which certainly were not necessary and could not be afforded.

In Australia we had the same kind of development, and we found the same thing in numerous South American countries. You can keep living beyond your income as long as you put these things to a productive use, so they will carry the debt charges and pay them off, but when you borrow and then have to borrow to pay interest yousre headed to break down. Take the skyscraper. A large number of our cities decided upon a program of extensive building and for a period of four or five years vast projects in connection with skyscraper developments werearredreed. I am not going

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3

to say whether such things as that were bad but I do want to say that when a large volume of capital flows into unaccustomed channels like the tremendous increase in paving and these projects end you are bound to have a tremendous let-down in the industries which supply the materials and labor. It is almost precisely the same thing as war - where you divest men and materials to uses that are abnormal, and then when war is over they seek back. We develop a new type of economic structure during this period. When the demand for these supplies and materials of war and the materials needed for a large construction program lets up there is bound to be a let down in the system which will have to digest a new set of conditions and try to work out some normal plan of operation. We have had all of these in the last few years and they go far in explaining the depression.

That is not to say, however, that the credit system or banking system may not have its part in such a decline. Any system which when operating successfully integreates the various parts can also disintegrate the parts. Eividence has been brought out that the banks of the country had gotten into some methods of finance that were not very sound and in this way contributed materially to the depression. When the banks came to the point where they were unable to meet their obligations the depression of purchasing power representad by deposits of these banks acted as a tremendous deterrent to trade, because it cut so heavily into the peoples' purchasing power.

I would like to refer briefly to some of the measures taken to try to get us out of the depression. The country of course, went

~~and Australia which exports wool, wheat, etc., they found the price of their commodities falling and they were getting less for them. Immediately that showed up in a loss of gold reserve of their countries. It was some~~ 32

off the gold standard last year. Measures very similar had been taken by a considerable number of countries before we attempted them. In 1929 Argentina went off the gold standard and in 1930 Brazil and Australia went off. In 1931, England and Sweden and a considerable number of others. We followed in 1933, so simply going off the standard was nothing new. In these other countries the situation had been roughly this: as the depression came on, these countries, particularly Australia and France, found that their exchange was going heavily against them owing to the fact that they were mainly suppliers of raw materials. Perhaps some of you have noticed the tremendous growth of basic supplies in the form of surplus accumulations prior to the depression. That growth was instrumental in causing prices of basic commodities to fall. In countries like Brazil which exports cattle, and the Argentine which exports cattle and wool, and Australia which exports wool, wheat, etc., they found the price of their commodities falling and they were getting less for them. Immediately that showed up in a loss of gold reserve of their countries. It was some time before the central banks took measures to protect the gold standard by that time the gold supply of Brazil was totally exhausted, and that of Argentina and Australia practically exhausted, and the situation still kept up. They got to a place where they saw they were going to lose control and they stopped trading. Immediately the exchange rate went against them. They were forced off by the world fall in the gold prices of their raw materials . Industrial products did not fall nearly so much and the purchases were maintained at a high level.

When England went off the gold standard the situation of the world became a great deal worse and in addition there was a growing doubt as to whether she would be able to pay her obligations. She has been in a large sense, the world's banker. Many South American countries kept a great amount of their gold/in their own vaults but in England, so when they began to fear England would go off the standard they started to withdraw this money , and you may have noticed that the loss was to great the Government had to step in and prohibit them. There was another instance of a country going off the gold standard in order to conserve what gold it had left.

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Our condition was a little different. There is still doubt as to whether we had to do it or not. We had a very large gold supply. although there were losses and a growing demand to export gold to France which was not suspected of being ready to go off the standard. We decided to g off the standard to get a certain price rise which came through going off the standard. The situation was like this: when the dollar falls in foreign markets in order to sell the accustomed supply of goods we still can only charge what we have been charging and that tends to fix the price level for the product not only in those countries but in our own as well. When the dollar falls in value one pound in Britain is not worth any more than before so the prices of commodities in those countries may rise and that is what happens to the products we exported. Wheat and cotton were outstanding examples; they rose almost exactly in price equivalent to the dpreciation of the dollar and other commodities which were affected by other conditions rose more or less; some things did not rise at all. We had a system of prices which responds to any influence of that kind.

~~of our prosperity. I assume that was one~~ ~~valued the dollar at 50% of its former value. Of course, you know that it had been at that value before we revalued it so far as its exchange~~ Still, prices have a very slow response. They are set by a comparatively few large companies at what they think the traffic will bear. Of course, many prices move very slowly in one direction or another but in commodities of international trade going off the gold standard causes a great rise and that involves commodities imported as well as exported. So in an effort to raise the price level of this country we went off the gold standard. First our exchange fell and we tried to drive it further down by adopting the gold purchase scheme - we said we would give so many more dollars for so much gold, and finally, after a period when the exchange had been relatively stabilized, we revalused. I assume we did that, gave a new metallic content to the dollar, because it was held in so many quarters that people were so alarmed by the changing value of the dollar that they were afraid to invest. The uncertainty of the situation prevented investment and construction that we felt were necessary to a restoration of our prosperity. I assume that was one of the major reasons they revalued the dollar at 50% of its former value. Of course, you know that it had been at that value before we revalued it so far as its exchange value was concerned. We simply said that if we ever do go back on the gold standard the content of the dollar will be smaller than it has been before. Having done that it gave a basis for other countries for to most people taking definite action indicates that unless something pretty bad comes up we are going to leave that value where it is, so other countries have something fairly definite to tie to, which is one influence toward stabilization. The other countries will have to adjust their currencies entirely to meet this new dollar situation. England has recently been moving in that direction. France has taken no move but she is apparently in many respects finding herself in a harder position than she wants and it makes it very difficult for her to get a volume of trade. Germany is in such a situation and there is no alternative. You will find a considerable reflation of currencies over a large part of the world. In many countries no definite reflation will be necessary except that they will simply go on the gold standard at the exchange values they now have. It seems very doubtful that France, Germany will be willing to leave their currencies at their present values. It is entirely likely they will find the countries with depreciated currencies will be able to export and any country whose goods and currencies are undervalued will outsell them and get the business, so the reserve will flow to those other countries. It looks as if the United States will be a sinking pot for gold unless reflation takes place.

I have rambled here trying to touch in general some of the things in which you might be interested and I think I will throw the meeting open now for discussion.

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Q - Taking conditions as they are actually today, what effect, if any, would the exportation of gold from this country to other countries have upon the value of our dollar in international exchange? Would it go up or down and why?

A - Before we exported gold there would be naturally some fall in our exchange. The export of gold does not take place without some fall, so that would be one of the first things that would happne.

It would be practically negligible. The next thing would be a tendency of the gold that we shipped abroad to build up the gold reserve of those countries. That would ease their banking structure and ease their exchange situation, and it might tend - probably would - to foment some additional business. Our loss of the gold in any moderate amount (and we could export a couple of million ddlars without any fear at all) would not cause any credit trouble in this country. We have one or two middle dollars sitting idly here. I should think that shipping abroad ought to serve some impetus to price levels if there is a trade demand. They may, of course, be in the same situation at present that we are with a credit basis for credit expansion that would support a volume of business several times as great as in 1929 that we cant get into use as there is no demand for it. I can say with certainty that the flow of gold abroad will increase their credit basis and put them in a position where it would be an aid to recovery.

Q - What effect would it have on our dollar?

A - As long as shipped that gold it would simply stay at the same figure unless the money might go to countries which are not on the gold standard. That would have the effect of strengthening their exchange and lowering ours althoug it would not necessarily lower it in terms of goods on a gold basis.

Q - Would you say something please about silver add the reason for the establishment of a new ratio?

A - Silver, of course, is not primarily an economic question. I think it is primarily a political one. There is only one important silver using country in the world, and that is China, where it is used as the money of the country. Those who have advocated the remonetization of

37

silver have done it on these amounts that are in China and have also pointed to other countries which do not use silver extensively as money. They say that silver is falling to such a low value that the moneys of those countries have no purchasing power and consequently we can't seal to them. They can't buy from us because their money has fallen so low. That involves a fallacy of thinking because the Chinese for years have been on an import basis rather than an export basis which shows they do not pay ? for their exports of silver. The reason why foreign trade went off so greatly is that China is an exporter mostly of raw materials and an importer of finished materials, and raw materials are much more sensitive to price fluctuations than finished. Her exports fell down in price more than her imports and that put her in an unfavorable position. The same is true of Australia, Brazil and the Argentine, all of them being supplies or raw materials. They had the same thing although they had a different monetary system.

One of the reasons cited for the remonetization of silver was to give those countries using silver increased purchasing power and it may interest you to know that China registered a protect against that and at the present time the price level is falling as a result of credit restriction because a rise in the price of silver in China has the same effect as a rise in the price of gold in this country. The more valuable gold becomes the less valuable other products become in terms of gold, which means that the prices fall. They are having deflation in China at the present time just as we did, because of the rising price of gold. Naturally they do not like that and it will have the effect of curtailing business activity, some effect on employment, so the chances are it will be more of a deterrent for trade than an aid. It will help certain countries that hold or produce silver for export. It will help Mexico in the same way as the rising price of wheat would help us. India would be happy to dispose of her silver stocks to us. Spain has a good sized silver stock but so far as this country is concerned silver if mainly a by-produce and the rising price may help somewhat the silver producing states. The political leaders feel that it will help them and, owing to the representation from the silver using states they have a political power that is somewhat out of relation to the population. So I think the political influence is more important than the economic one in causing silver to be purchased with a superficial value placed upon it.

Q - Did lowering the gold content of the dollar have the desired effect - the one that the economists predicted.

A - That is a matter of debate. Doctor Warren, whose brain-child it was, said it did have the desired effect. Most economists would say it did not. You would have to know what the desired effect was. It had the effect of raising ~~prices/that~~ of commodites entered into international trade but only to a moderate extent in other commodities. I would say there is no question but that some increase in prices took place as a result of going off the gold standard. Personally, I do not think it was what was expected. I do not think it amounted to anything like what had been expected would be the case.

Q - Do you feel that ~~this~~ is an attempt to create a rise in prices insofar as these lagging items, such as the cost of living, are concerned?

A - I think in these lagging items, much would depend upon whether this detail is worked out on those things that do not lag. You speak of rising prices in the lost of living. I do not see how there can be anything other than an advance in prices - not just here, but all over the world. I do not know when and there may be hitches before it comes, but I think that ultimately the chances are strongly in that direction for the reason that we ha ve recently gone off the gold standard and I think other countries will have to revalue their currencies. There is the credit basis, the basis for credit expansion which, other things permitting, will afford a very great expansion of activity. I am somewhat orthodox - which just means old-fashioned - in my views of this thing. I think, given time, almost any situation will work itself out and whether we have a recovery program or not, given time, we will arrange ourselves and get on with progress. I look, either through the recovery programs or through the working itself out process, for us to get on a basis where profits can be made, it will be possible to expand business, and within a couple of years I think we will see things moving on a more active scale and prices advancing.

Q - What restrains a country from inflating its currency to get the world market? -

A - This is the restraint. You can only inflate a given amount. You blow a tire up to 35 pounds and then stop. However, you do not have as good a regulator on this sort of expansion as you have on a tire. You may blow the tire out. Take Germany, for instance. She would rather have the present bad situation than to have another inflation such as she had a few years ago. There the situation ran away with itself. The people of France feel that even as they are today they would prefer it to running the risk of inflating the franc. There is this much to be said; those countries at the time of the inflations were having a very difficult time balancing their budgets. They could not keep their expenditures within their incomes and they issued bonds. The central banks took those and gave the Government credit for them which the Government then spent and that spending reached a point where they could not stop it. As prices started to rise the people began saying that these higher prices would make the Government spend even more money and the situaton grew worse. We have in this country safeguards that some other countries do not have. We have a lot of gold that could be used to cut out our budget deficit.

Q - What will happen to the present gold money we have? For instance the present ten dollar gold piece is worth $16.85 in gold. Will it have to be melted?

A - There is gold out that will have to be burned out and I expect that if we do coin gold again it will be a different size, and anybody who tenders gold again will have to, in a sense, bootleg it or sell it to a fence who will melt it down. It is not certain we will mint a new gold coin at all. We do not have much use for them except at a time when people are making a run on the banks. It isprimarily used for shipments between countries.

Q - What do they do to keep money in this country? If you wish to buy a draft on London you have to sign a certificate of some sort.

A - It would seem that this restriction was to put the Government in a position to prevent the loss of gold. If that draft were presented in

41

London it would constitute a basis for the loss of gold.

Q - You mention the fact that loans had been made to foreign countries for certain social purposes as distinguished from economic purposes. Is there any understandable way in which it would be possible for these countries to go ahead and pay off these bonds or should we write them off as debts.

A - That is a moot question and I can only give my view of it. I do not see any earthly way for these countries to pay off these obligations unless they should follow some policy like France followed in the war, devalue their currencies to a basis where they would have the advantage in foreign trade and then be able to exert a pull of gold toward them, and use that gold to cut down their obligations abroad. There you run right smack into the disinclination of any nation to sell its goods there, so I think it depends entirely upon whether we are willing to accept imports, but personally I do not know as I see no reason we ought to try it. I think this country is very naturally a capital accumulating country now and with a forein loan policy on a sound basis we ought to try to collect service on the debt. It would not have to be in the form of gold. The only they could pay would be in the form of exports and our industries do not want them. Instead of thinking about collecting the debt it would be a great deal better to see if some arrangement could not be made to collect the service on it and be a capital export country in the future. Economically we have reached that stage in our development.

Colonel Jordan: Professor Garlock we want to express the appreciation of this College for this very fine presentation.