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CURRENT FINANCIAL SITUATION

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It is a great pleasure to come here I don't know that I can contribute very much in the course of an hour because I hardly know what it is you are working on and thinking about You look like people whose first question would be apt to be "What about inflation? Are we going to have it, and, if so, when?" Thus perhaps I might as well begin with that and then ramble off into other matters

We have the materials for a very great expansion of money, using the term in the wide sense of currency and bank checks. Our Federal reserve system has an enormously high reserve ratio which would permit it to expand credit greatly, and the Treasury has a lot of honest-to-goodness gold which it might put into the Federal reserve and increase the reserve of the Federal reserve banks enabling them to expand credit

The commercial banks have large excess reserves over requirements and they can expand credit over a vast extent If that were done we would have inflation because the quantity of the circulating medium would increase far more rapidly than the volume of output of goods and services. Why does it not happen? We have easy money at abnormally low rates, but there is not the demand.

There are circumstances under which, given the present situation about gold and excess bank reserves, we would have an inflationary spurt without question. We had one, for example, during the war. During the war there was a lull of employment of labor People in business were confident that they could sell at rising prices all that they could possibly produce They competed actively with each other to secure materials and labor, the explanation of course being the large number of men drafted into the Service and the enormous consumption of material in the course of the war

Now we do not have a situation of that sort It is not the case that everybody engaged in industry sees possibilities of selling at increased prices more than they currently are producing, and consequently they do not rush to the banks to secure additional funds with which to buy more labor and materials. Marketing is difficult at present, and that is the real problem of recovery, it is the problem which presents itself in connection with inflation You are hardly likely to get inflation of a business type at a time when for one reason or another people

in industry do not feel that they can sell an indefinite increase in output at present prices. You could, of course, have a fear inflation, that is very different. If our rulers were to adopt the theory that the way to meet obligations in this country was to increase the budgetary deficit and to meet that deficit by printing paper money instead of meeting it by borrowing, after awhile I think without doubt a fear inflation would start.

Suppose, for example, Congress took the view that it would be desirable in meeting the bonus payment not to borrow but to print paper money, and, if that did not turn the trick, to print paper money for other expenditures of the Government. After awhile we would all begin to feel doubtful about the value of our money and our bank balances, and we would rush into buying tangible things to get rid of our money and get something tangible That would probably induce inflation for the time being, and an inflationary upward movement of prices. So far as I am aware the Administration is not disposed to try that particular monetary experiment. Therefore, I am inclined to believe that the danger of inflation will not present itself until somehow or other the situation becomes such that there is a rapid increase in demand for materials and labor with ready sale of output, which would induce business concerns all over the country to apply for more bank loans. Then the question of restriction might present itself.

I turn now to the question of why an increased demand for labor and materials from the business community has not developed more generally, quite independent of work relief and other governmental expenditures.

Broadly speaking, there are two types of products - consumer goods and capital goods. It is the practice of large numbers of people to save some of their income and to seek to invest it. If the investment is actually made - if it is a new investment - that means a demand for one or another of the things known as capital goods required for new structures, new equipment, etc. It is that class of products for which the demand is relatively weak In the case of the consumer goods industries, employment is fairly good, it is relatively low in the capital goods industries, so the real problem of further trade recovery is, in a large part, the development of a situation in which there shall be an increased demand for capital goods associated with the employment of new savings currently being made. If that develops, the increased employment of the people in the capital goods industries will result in an increased demand for consumer goods and thus more employment in those industries. The problem really is to bring about this

increased demand in the heavy industries, and the problem is a very complicated and difficult one

To some extent additional investments and the consequent demand for the products of the heavy industries can be influenced by a low rate of interest, say 4% rather than 6%. At that lower rate people may be disposed to make certain capital improvements that they would not make at the higher rate of interest.

Much effort has been directed toward securing lower rates of interest That is the purpose of the so-called easy money policy That policy affects directly and immediately the short term rates of interest, the short term obligations of the Government are being marketed at rates of interest under 1%, and some of the longer notes of the Government are at interest rates only slightly over 1%. From that point we have rates of interest all the way up Interest rates for long term capital have gone down somewhat, but they have not proved very susceptible to the influence of easy money - not as much as might be hoped

In England the long term rates for house mortgages have gone down to the neighborhood of 4% In this country they dropped from 6% to 5½%. That is hardly enough to exert a very considerable influence on the use to which additional capital might be put.

There is another factor, however. What can you get in the way of bricks and mortar and machines for a given amount of money that you might put into an enterprise? It happens that the prices of the capital goods industries, in spite of the rather modest demand for their products, have been relatively stable Steel prices, for example, are in general not more than between 10% and 15% under the maximum steel prices of 1928.

There has not been a reduction in the prices of most capital goods comparable to the reduction in many other fields, particularly agricultural products Of course, the capital goods people say that the demand for their products is an inelastic demand - that if you reduce the price of steel products it will not increase the demand very much, and will not increase appreciably the total cost of products in which steel is used It is pointed out that a reduction of 10% on the steel going into the Chevrolet would probably only reduce the cost by about $8.00, not enough to make for lower car prices. Therefore, there would be no more absorption of steel. There is a great deal of force in that contention if you pick a single product, although I think the steel people exaggerate a bit because

there are other uses for steel in which the cost of the steel is a very much greater factor than in the case of a motor car.

The policy that I have been urging ever since I came back to this country is that the way to secure a greater demand for the products of the heavy industries is a concerted reduction in prices of all of the various products of the heavy industries, that if you could bring about a concerted reduction of steel, cement, bricks, window glass, and all the things that go into construction, then you might expect an increased demand, particularly if it were associated with lower interest rates and perhaps also a temporary reduction at least of transportation rates on products of this type. That, in my own judgment, is the way to induce an increased demand, thereby increasing employment with the final result of lessening the need for Government relief for the unemployed It would also be some help toward balancing the budget but that has not been the policy which we have adopted in dealing with the depression We rather have adopted a policy of trying to maintain prices, and even to increase them, for all kinds of products. There was a great deal of merit, it seems to me, in the objectives of the A.A.A. in reducing acreage and reducing the output of agricultural products because prices of those products had dropped to a far greater extent than was the case of industrial products, owing to the fact that the farmers were so numerous and the processes of production so long that they could not of themselves, acting as individuals or in small groups, do anything worth mentioning toward the adjustment of output to demand.

Contrast that with the situation of almost any industry, especially those conducted by a few large concerns They could change their schedules of production from month to month or from week to week If, during the next two weeks, the orders coming into the automobile business indicate a demand below what is anticipated, they will change their schedules of production almost over night. The farmer cannot do that. Moreover, there is not an elastic demand for his products especially when you get them down to a low level of prices. It always seemed to me, therefore, that the policy of restricting the output of agricultural products was wise if it were clearly understood that it was a temporary measure designed to carry over until somehow or other industrial development might absorb some of the surplus labor at present attached to agriculture. But that is not what was done. We went on from the A A A to the N R.A , which tended to crystallize the status quo in the industries of the country. No sooner had the code become established than the steel people moved up the price of steel products. That, in my judgment, was not the way to attack the problem

If you are seeking to increase the demand for labor and for materials, in some direction or other you must develop an additional demand, and the problem is how to do it. Some people argue that you can increase demand by increasing consumer purchasing power, that the increased demand in consumer goods will in the course of time react back upon the heavy industries and upon investment So there is a good deal of support for the proposition that you had better move up wages because that will increase consumer purchasing power. The difficulty with that is - and I am not speaking of the case of abnormally low wages but as a general proposition relating to wages - that not all consumers are wage earners You do not get so pervasive an influence affecting demand by an increase in wages as you do by a reduction in price of those products for which there may be presumed to be an elastic demand on the basis of present incomes if you reduce the price Take the difference between increasing wages in the automobile industry with a consequent increase in the price of motor cars by $50 or $100 apiece. This will cause some increase in consumer demand among automobile workers, but I contest that it will not be so pervasive an increase as decreasing the price of the car and leaving the wage income as it was.

Not all income is derived from wages You tap every consumer when you offer a product at a lower price, whereas you tap only a restricted demand when you increase wages or rents or profits. I repeat the qualification that in particular situations wages may be abnormally low, just as in particular situations profits may be abnormally low or nonexistent

We have finally rid ourselves of the N R A. but we have not rid ourselves of the kind of thinking and the methods of pricing which characterized the N.R A That brings my talk to where it was before, to steel pricing and the like Although with the elimination of the N.R.A some prices have become a little less rigid than they would have been if the codes had been maintained, we do not have that general acceptance of the possibilities of an increased demand through price reductions that would appear to me to be necessary to induce an increased demand for labor and for materials.

Let me take one more situation Technical improvement in an old product inevitably means, if it is a real improvement, that a somewhat smaller amount of labor will be required to produce a given quantity than before In spite of the technical improvement, if the price is not reduced the demand will not be increased and a certain amount of labor will necessarily have to be dismissed. If, on the other hand, you

pass on to the consumer the benefit of that improvement in a lower price, then it may be that the increased demand will make it possible to maintain the demand for labor as before. Even if it does not, at least the consumer will have a little more money to spend on something else and so increase the demand for labor in some other direction.

I suggest then, that in a period of rapid technical advancement, we need a pricing policy which speedily passes on to the consumer the benefits of these improvements. That will happen speedily if it does not take too much time for new people to enter the occupation; but as you know in the case of many products the capital investment is very large, the time element is long, and so you can have a price maintained to a large extent in spite of technical improvements.

These then seem to me to be the fundamental questions involved in bringing about an increased demand for labor. Nothing can be done by exclusive attention to some one factor, whether it be the price level, the rate of interest, the pricing policy, or what not. The problem is difficult and needs to be approached from a variety of points of view, with a clear recognition that the fundamental objective is the lessening of unemployment and the development of conditions which will induce an increased and a maintained demand for labor and materials. When you do reach that point there may be danger of inflationary advances in prices which will require restriction and which will prove very difficult to restrain. The present problem is not a price problem. Practically all prices have now reached what I think may be called a tolerable - an endurable level - and that was not the case with prices two or three years ago. Some of them were then intolerably low, but for the immediate future the desirable thing is some reduction of prices of certain commodities for which there is presumably an elastic demand, and in particular a concerted reduction in the prices of all of those products of the heavy industries that are used in association one with another.

Although I am supposed to be a monetary or banking expert, I find it necessary to branch off into other fields. I used to tell my classes, and some of you will remember it perhaps in the beginning of my course, that in running a bank the main thing was to know about other people's business That is true when you come to questions of monetary policy You cannot by monetary policy do everything, but you may influence a situation desirably or undesirably. It is what people do under the impact of your monetary policy that is decisive. It does not follow that greater confidence about money would be helpful always. It would depend on what business would do if

500

it had more confidence Suppose, because of greater confidence, the steel people who are now filing prices of steel for the next quarter were to increase the prices of steel In my judgment, that would, in large part, neutralize and even more than neutralize as a recovery influence whatever value may be attached to increased confidence in the currency and in the monetary policy generally of the Government

We had confidence, you will recall, in the period of the previous administration, and we had a balanced budget, and yet things generally went from bad to worse Evidently, somehow or other, we did not do the right thing although we had confidence

Of course it may be argued that conditions have so changed that confidence alone would now be enough to induce a real trade recovery That is possible, but I would be disposed to think that it is by no means a certainty, and that confidence, if it were associated with an intelligent and enterprising pricing policy, would be far more certain to yield that trade recovery than confidence alone if that confidence were to lead to a restricted pricing policy in the case of the heavy industries of the country

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DISCUSSION FOLLOWING LECTURE
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Q. I would be very much pleased if you could give us something of the effect that might be expected as a result of the depreciation in the value of the dollar, or rather the increase in the price of gold under the conditions which have prevailed and in which the gold itself has been sequestered and maintained practically intact in the Treasury Its not having been circulated has apparently had very little influence on prices

A When the dollar was first depreciated after we went off gold and then was revalued, you and I did not have any more money in our pockets and you and I did not have any more to our credit at the banks against which we could draw checks There was not, in other words, as a consequence of going off gold, any increase in the purchasing medium. Now let us consider whether the going off gold exerted an influence tending, in the course of time, to increase the purchasing medium We might have been in a situation at that time of possessing only a very small amount of gold with the consequence that the Federal reserve banks would have been under the necessity of contracting credit and the various commercial banks would have been under the same necessity. In such a situation the going off gold might have been helpful in preventing shrinkage of the purchasing medium.

In France many people are doubtful whether the country can stay on gold and so from time to time people hoarded gold or shipped it out of the country This is tending, in that country, to contract the total amount of the purchasing medium We were not in that situation Our great trouble was that the people had lost confidence in the solvency of their particular banks and were taking out money for that reason. It eventually became necessary to close the banks and then reopen them with the practical assurance on the part of the Government that the reopened banks were solvent. That allayed alarm and there were no further withdrawals because of the fear of solvency of banks.

The Federal reserve had plenty of gold with which to grant further credit and the banks had excess reserves Therefore, going off gold as we did, did not change the situation

appreciably as far as the supply of the purchasing medium was concerned.

What the going off gold did was to affect the situation as regards exports and imports As the dollar became less valuable in terms of other currencies we obviously had to pay more for imports than was previously the case Take the case of a product like rubber which is entirely imported - with the dollar at a lower value obviously we had to pay more for rubber in terms of the Dutch guilder or the pound sterling because it would cost more to buy guilders or pounds sterling. The same thing is true in the case of exports If the price of cotton were 8 pence a pound in Liverpool and continued to be 8 pence a pound after we depreciated the dollar, then cotton exporters would get more dollars when they converted the proceeds from the sale of cotton into dollars than before depreciation. That would have the tendency, to some extent, to improve the price of cotton. It would not have as big an effect in the case of this country as in some others because exports are a smaller factor in the situation For example, last year the Belgians revalued their currency, depreciating it 28% That is a very small country, using a much larger percentage of its labor in producing things for export than is the case in this country. The effect, therefore, in the Belgian case was quite pronounced both for the reason that it is a small country and also because it removed that pressure which was present owing to the fear that the country would not be able to maintain the former value of its currency, leading people to hoard and seek to secure gold for export.

I am, therefore, doubtful as to whether the depreciation of the dollar and its revaluation has had an important influence on this country either on prices or on the total demand for labor and materials Whatever influence it has had, its effect was slight owing to the conditions which I have mentioned.

Take a third case, that of Britain, which went off in 1931. They simply did not have the gold What gold they had was used defending the pound The situation of the country with respect to balances of payments was so unfavorable there seemed no way of maintaining the gold standard

We had the gold and our international payment situation was favorable. Even after we went off gold it was difficult to keep the dollar in a depreciated condition. It tended to snap back to its old value in the summer of 1933, even though we passed the Thomas Amendment and it was quite evident that the

temper of the people was highly favorable to a lowering of the relative value of the dollar Still the dollar tended to snap back, and finally the Warren plan of buying gold at higher prices was put into effect, but even that was not particularly effective. You would naturally suppose that such a determination on the part of the Government to depreciate its currency would be accepted by the rest of the world, but when they stopped further advance in prices of gold the dollar again tended to snap back, and the only way to maintain the degree of depreciation that had been reached was to nail it down, putting clamps on it by returning to gold and agreeing to take it at $35 an ounce By that method the depreciation was fixed and made certain, because thereafter gold came in in enormous quantities, and we acquired more than two billions at this price. That was sufficient evidence that the dollar was, at the new price acquired, very greatly undervalued

The question that was put to me contained another point. It seemed to imply that because gold is no longer in circulation or because the banks do not have it that has made a difference in the situation. I don't think that is the case. It is not necessary for gold to be in circulation to have an effect upon prices. Gold is really the foundation of the total circulating medium, consisting of currency and bank balances. If the Treasury locked up the gold to such an extent that it reduced the surplus of the Federal reserve banks below their requirements, compelling them to contract credit, then you would have a situation in which you might say that the policy of the Treasury was affecting the supply of the purchasing medium, but when you discover that the commercial banks have between two and three billions of excess reserves, and that the Federal reserve banks have excess reserves of a billion or more, it is difficult to see how, by the further use of its gold stocks, the Government could appreciably affect the mode of use of the circulating medium of the country It would be possible for the Treasury to transfer in the form of gold certificates a couple of billions of dollars. That would increase the excess reserve of the Federal reserve banks and would give the Government additional balances at the reserve banks which could be checked out in meeting ordinary payments of the Government These checks would be deposited, thus giving banks additional excess reserves and probably running up the reserves of the member banks from the present figure of two or three billions to between four and five When you already have such a huge excess reserve the addition of some more is not likely to have any appreciable effect.

Q. You have shown how the present situation is potential of inflation in case the demand should develop. A major war would create that necessary demand Can you indicate what the proper financial policy of the Government should be in case a war came soon?

A. That is a subject in which I have a keen interest I tried to start a movement during the last war to have it largely financed by taxation as we went along, and I got some effect but not as much as I had hoped. I imagine that any future war, if it is to be prolonged, must be financed by taxation and inflation and not by loans for the reason that various governments of the world, including our own, seem to have incurred such a huge amount of debt already that none of them would be regarded as a good risk purely as an investment proposition in the event of another major conflict.

That is only one reason, but there are other reasons for my opinion that a war can and should be financed currently while it is going on. If you do not do that you inevitably have competition between civilian demand and military demand. We had that in the last war. The Government, in possession of a vast amount of purchasing power created by loans, entered in the market for commodities and competed for goods and services with those of us who remained at home, with an inevitable rapidly rising price level. I recall that I urged a 25¢ tax on gasoline principally to free transportation from the burden of carrying gasoline for the individual consumer. That was regarded as quite a horrifying proposition Some taxation experts opposed it on the ground that to impose a heavy taxation upon them would deaden the determination of the people at home in conducting the war In a situation in which general conscription is required of all people capable of serving I am confident that the civilian population will endure the burden of whatever taxes may be imposed. The point that I did not consider sufficiently in the last war was that we were not at that time well organized to shift over from civilian to military production. You must know what you want for military purposes and know at the outbreak of the war where what you do want can be most effectively produced.

I take it that you have been working on plans for war production and that you know what can be produced and where. I see no necessity, then, that the things you want and will need need be produced at higher prices (whether for labor or materials) than those which obtain at the outset of the conflict There is no reason so far as I can see why

trucks or saddles or anything else need go up in price if you issue orders at current prices at the beginning of the conflict. If you want a product in greater quantity than that which can be produced with existing equipment, I do not believe that the effective way of getting it is to go out and bid for it. I recall a case in the war of a certain product that was wanted to the extent of something like 120% of maximum capacity, and various agencies were competing with each other to get some of that product Naturally its price went up, but they did not get 120% until after the additional facilities had been provided, and these additional facilities could have been provided far more immediately than was the case following the then present practice of various agencies issuing orders

If you know what you want and where it can be produced, then the appropriate taxing policy can be adopted which will be a policy of financing the war while it is going on. Every effort should be made to prevent a general increase in price, which is of no value whatever from the military point of view and undesirable from the social point of view, because it produces a situation of social unrest damaging during the period of war and thereafter.

Q In regard to the decreasing of the wage level during the depression and the effect on the demand for labor and capital goods, the policy of the Administration has been to maintain prices including the price of labor I have been thinking of Japan which has a planned economy and which has been successful with it based on a relatively lower wage level. What would be the effect of a lower wage level on the demand for capital goods in this country?

A That is a very complicated question. Just a word about the Japanese situation. They have been seeking a way out through the expansion of their foreign trade and by the method of wage reduction, though I don't think it is entirely by low wages. By these means they have succeeded in improving their relative position in foreign trade and it is something that a single country cannot do, especially if it is a small country in relation to the total world market. I don't think we could accomplish so much by that method because we are so huge that to really make a great impression upon employment through an increase in foreign exports we would have to export so much that we would submerge the rest of the world. In this country, therefore, I would examine that wage problem only in reference to an internal demand for additional labor and material If you could make an adjustment all the way round, including the

burden of interest rates, rents and wages, and induce a corresponding reduction of retail prices, then I think there is a great deal of merit in the wage reduction theory as a means of restoring the balance, that has been done in Australia. It is not in my judgment feasible to concentrate the reduction mainly on labor. I do not think that is the way out. Rather, if wages are to be changed, I should say that the wage reduction should be made where you may expect a localized increase in demand.

Take building, for example. If you could get concerted reductions in the prices of cement and brick and steel designed to increase volume, and some reduction in transportation rates of those products, then you could go to the building trades unions where wages are relatively high and suggest temporarily a wage scale of something under a dollar rather than above.

Q. What is the effect of the recent change in the make-up of the Federal Reserve Board and the removal of the Secretary of the Treasury?

A. I think it tends to make the Board a more independent agency. It seems to me desirable that there be a separation in personnel, and, with the increased power that is given the Board of Governors under the changes in the law, I think it is even more important that the Board occupy such a distinguished and dignified position that it will be possible to secure first-rate men for these posts. Certainly, in the past, many good men have declined appointment on the Federal Reserve Board. I think that posts on that Board have been made more attractive than in former times.

Q. We have heard it said that you made the statement that this country could readily support a forty billion dollar debt. If that is correct, can you tell us how you arrived at that figure?

A. I don't know whether I said forty or not, but if we are prepared to endure a burden of taxes as heavy as that which obtains in England, we have not reached the limit of the debt as yet, even if you include the local and state debt. That is not saying that it is desirable to go to forty billions. I have also said this. In going to the figure of whatever the maximum is, we will not arrive at it before a collapse in the Government credit if we do not see any end to the increase in debt. Let us start with an assumed addition of three billion dollars to the debt this year, if next year the increase in the

debt is two and one-half billion, and the year after, two billion, and gradually moves down to zero, we can very considerably add to the total of the debt without any weakening of Government credit. If, however, the debt increase this year is three billion, three and one-half next year, the possibility that it might be four the following year, and no one knowing what it would be in the fifth year, then I think that Government credit would be seriously weakened long before you reached that maximum that might be attained if the trend is in the reverse direction.

Q. Recently there has been wide publicity concerning taxation on corporate profits What effect would that have on money should it become effective?

A. That depends on whether the propensity is to consume as contrasted with the propensity to save. On the whole I think it would slightly increase consumption because if more is paid out in dividends certainly not all of that which is paid out will be saved and reinvested by the recipients.

Q Would you say something as to the basing point of steel - its advantages and disadvantages?

A I would rather not. I talked to a committee in the Senate yesterday and began by saying I was not a technical expert I might say it facilitates maintaining a more or less fixed or uniform price scale throughout the industry which adopts it Since the steel people honestly believe in the stability of prices I don't think there would be a very big change if your basing point price system were abolished. I don't see the chaos that the steel people insist would follow.

Q I was interested in one point you brought out. You mentioned the fact that short term money rates are low but that long term money rates had not fallen in proportion. Just why is that so?

A It is partly due to the fact that we have such a large number of lending agencies as contrasted with Britain, for example Take the matter of building loans A large proportion of the capital available for house building in that country comes from building societies, and there are eight or ten of them doing pretty much all of the business When one of them starts a reduction, it has got to be followed by the rest In this country there are hundreds of different agencies scattered all about for the purpose of loaning money for that

particular use and they are just as much influenced, perhaps more, by the desire to pay high interest rates to the stockholders as they are in stimulating building. That is the kind of explanation I should give on the slowness with which the change comes about. On gilt-edge bonds the rates have gone down quite as rapidly as in Britain, but that has been mainly for large concerns enjoying the very best of credit and even so they have not been induced to expand very much. So I feel we have got to have a combination of low cost for materials and low rates of interest. If you are in a situation where you feel certain it would cost you more to make improvements two years hence than it will now, and if you can get the money cheaply you may go ahead. If you can't you are less likely to go forward.