3. The Recession of 1937–8

In late 1935 those of us in the Federal Reserve System began to watch with concern how a heavy influx of gold to America, stimulated by the Treasury gold-buying price, the dollar shortage, and unstable political and economic conditions in Europe, swelled the volume of excess reserves already on hand. It could become the basis of a potential expansion of bank credit of such proportions that the Federal Reserve could lose all control or influence over the supply and cost of money.

At the time of which I am speaking, opinion was divided over what should be done. The Federal Advisory Council, for instance, adopted a resolution on November 21, 1935 recommending that the Board of Governors and the Open Market Committee take action to cut excess reserves either by selling a portion of the Federal Reserve holdings of government securities or by raising reserve requirements of member banks. As between the two methods it preferred the former.

The Board of Governors, on the other hand, declared one month later that while the volume of excess reserves was far beyond existing or prospective needs of business, there was as yet no evidence of overexpansion of business activity or of credit. It added, however, that the problem created by excess reserves would continue to be studied with a view to appropriate action at such time as might be in the public interest.

These discussions within the Federal Reserve System were echoed in the banking community as a whole. For instance, while Winthrop W. Aldrich, chairman of the Chase National Bank, urged an increase in reserve requirements, S. Parker Gilbert, a partner in J. P. Morgan & Company, and one of the most enlightened bankers in America, took a strong stand against any increase.

In a letter he sent to the *New York Times* on December 18, 1935, Gilbert stated his opposition in terms similar to those used by the Federal Reserve Board on that same day. He observed that for the moment there were few or no signs of any dangerous inflation or credit expansion; that any action to check a credit expansion "which admittedly did not exist" would run the risk of checking recovery and might start a new period of deflation; that since the great increase in reserves came from net gold imports, a stabilization of conditions in Europe might find that gold being reclaimed by foreign countries; that if some check on credit expansion should be necessary, it would be better to use traditional central-banking instruments of open-market operations and changes in the discount rate to achieve the desired results. He added:

> There is also a general consideration bearing on the whole problem of recovery, namely, that any restrictive measures which were to be taken at this stage by the Federal Reserve authorities, whether by raising reserve requirements or by letting government securities run off, might be construed as a reversal of the cheap money policy which has been pursued since the days of the bank holiday. This monetary policy, it may even be said, is an essential of recovery, and in recent months it has really begun to work.

There was much wisdom in Gilbert's words of caution against increasing reserve requirements at that time, but in the ensuing months many of the assumptions on which they were based had been outdated. European conditions remained disturbed, and gold continued to flow toward America, so that by July 1936 excess reserves reached a record level of three billion dollars. It was at last clear that we had to increase the required reserve sufficiently to bring under the direct influence of open-market operations the reserves that remained. Even if the increase was as much as fifty per cent, the remaining reserves would still be beyond current or prospective needs of business and would provide a more than adequate basis for legitimate credit expansion.

The longer action was delayed, the lower the interest rate would go and the more difficult it would be to deal with any inflationary consequence that might develop. Since the banks in the meantime would try to overcome the declining rate of interest by increasing the volume of loans and investments generated by these excess reserves, any later order for a substantial increase in the required reserve would lead to a liquidation of holdings and a painful deflation.

On July 9, 1936 I called at the White House and presented this issue to Roosevelt, though under the Banking Act of 1935 the Board could change the required reserve without his approval. Yet I felt the country would hold him responsible for whatever was done. Therefore, as the liaison officer between the Board and the President, I explained why we proposed to order a fifty-per-cent increase in the required reserve. At the same time I indicated the kind of reaction we could expect.

The memorandum I gave him on this point reads as follows:

> Action may be misinterpreted as putting the brakes on recovery just as the capital market is reviving and new investment and construction are getting well under way.
>
> Banking opinion is divided with an apparent preponderance now opposed to action. Those who had been most sympathetic toward Administration policy, including the Morgan partners, have been against action—so is David Stern.
>
> The Lemke-Coughlin group might be expected to attack the action as restrictive, deflationary, and typical of the "money-changers."
>
> The action contemplated will not satisfy those groups which have been clamoring for action in the hope that it would stiffen interest rates. If there was any serious danger of such a result, I should oppose action.
>
> I would not favor action under any circumstances unless assured of authority through the Open Market Executive Committee to counteract any recession of a point or more in the price of governments [securities].

Following this White House call, the Board of Governors issued an order, effective August 15, 1936, which raised reserve requirements for member banks by the amount indicated. This decision was in the nature of a precautionary measure. It in no way reversed the Board's easy-money and credit policies, though, as expected, it was widely judged as doing just that. That the $1,790,000,000 in excess reserves which was siphoned off merely eliminated what was superfluous to the needs of commerce, industry, and agriculture was shown by subsequent events. Reserves were still so large and so well spaced that all but a few member banks met the August 15 order either by utilizing their excess reserve balances with the Reserve banks or by drawing upon their excess balances with correspondent banks. Moreover, the change had no effect on the credit situation.

This hurdle passed, a new one soon loomed up. The European situation became even more tense in the latter half of 1936, with the result that a new influx of gold increased member-bank reserves by an added $600 million. Though required reserves in the meantime had also increased, owing to a growth in member-bank deposits, excess reserves grew even faster, so that by November 1936 they amounted to $2.2 billion and all signs pointed to an accelerating rate of increase. Nor was this all. Total bank deposits and currency, representing the most liquid resources at the disposal of the public, were at a higher level than in 1929. If utilized at a rate of turnover comparable to pre-depression levels, they would be sufficient to sustain a vastly greater rate of business activity. But in order to sustain and expand recovery, the economy required *a more complete and productive utilization of existing deposits rather than further additions to the amount available.* The presence of excess reserves did not in itself result in the creation of new deposits or in a more active use of the existing supply. But it was estimated that the existing excess reserves, if used as fully as in the past, would form the basis for an expansion of deposits of between $15 and $20 billion. Even if reserve requirements were increased by the full amount permitted, the excess that would still remain would form the basis for a potential credit expansion of more than $5 billion without further action by the Federal Reserve banks. As part of the effort to prevent further growths in excess reserves, the Treasury sterilized in an inactive gold account all gold purchased after December 23, 1936. But this did not remove the potential inflationary force of the reserves on hand. Accordingly, on January 30, 1937 the Board of Governors announced a 33⅓-per-cent increase in the required reserve. This represented the limit of the Board's authority to take such action. Of this final increase, one half of it was to go into effect on March 1 and the other half on May 1.

Prior to the announcement of this decision there was some disagreement within the Board of Governors on the extent to which the Open Market Committee should support the government bond market if it showed signs of a sharp decline. Some Board members, along with George Harrison and other Reserve Bank presidents who were on the Open Market Committee, seemed to feel that vigorous action would be inconsistent with increasing reserve requirements. My own view was that if bond prices showed any signs of decline, then the Open Market Committee should do what needed to be done to stabilize the situation.

That there would be some selling of government securities could be foreseen. While the banking system as a whole had a great excess of reserves, to meet the Board's new order individual banks would have to sell some government securities. On the other hand, banks that could buy those securities would defer doing so in the belief that if they waited longer, prices would drop still further.

To forestall any disturbance that might follow, after some discussion the New York Federal Reserve Bank in its capacity as agent for the Open Market Committee was instructed to make purchases in amounts that could hold the security market steady.

When March 1 came and the first increase went into effect, some of the banks, as was anticipated, began to unload their securities. But the New York Reserve did not handle the market situation as some of us hoped it would. It bought securities in only small amounts. The government security market sagged to an alarming extent.

I was out of Washington when this happened. After hurrying back to do what I could to correct the situation, I found Secretary Morgenthau understandably disturbed about the fall in government bond prices. He insisted that the Federal Reserve Board rescind its order for the second part of the increase, which was to go into effect on May 1. In a tense meeting at his home on Saturday night he let it be known that if the Board failed to do what he urged, he would release a substantial amount of sterilized gold and thereby create new reserves that could be used to bolster the government bond market.

I insisted that he and I should see the President before anything was done. At a Sunday afternoon meeting with Roosevelt, I expressed the view that what Morgenthau proposed would indicate that the Administration was incapable of pursuing a steady course of action. Second, it would indicate that the Secretary of the Treasury had taken over control of monetary and credit policy. Third, it would inform the nation that the Banking Act of 1935 was a failure, in that the Open Market Committee, for whose reorganization we had fought so hard, failed to do the work expected of it.

None the less, I assured the President that if in a week's time we did not stabilize the price of government securities through open-market operations, I would be the first to favor what Morgenthau wanted done. On hearing this argument and an account of how the New York Reserve Bank had conducted matters, Roosevelt gave me the week's grace for which I asked.

Thereafter new instructions were sent to the New York Reserve Bank which could not be misinterpreted. The bank presently undertook the sort of volume purchases that should have been made at the very outset. The downward fall of government securities was immediately stopped. At no time subsequent to the second increase were the excess reserves in the Reserve System less than $500 million over and above legal requirements. And, in itself, this sum was far greater than the amount that sustained the boom of the twenties.

Those who argue that the increase in reserve requirements was meant to tighten money rates and that this in turn parched the flow of credit into the economy and thereby precipitated the recession of 1937–8 could prove their case if they demonstrated that the increase resulted in any credit restriction or any material rise in interest rates. There was, it is true, a sharp rise in Treasury bills from a very low rate in the latter part of 1936 of 1/10 of 1 per cent to 3/4 of 1 per cent at times in 1937. Also, the market yield rate on three- to five-year Treasury notes rose from around 1 per cent to over 1½, and the average yield on long-term Treasury bonds rose from about 2½ to 2¾ per cent. But the levels reached were not high. Neither were the degrees of change large compared with those in previous periods, nor was the rise in rate long sustained.

It is true that at the end of 1936 and early in 1937 strong pressures were exerted by some financial circles for higher interest rates. It is also true that there were some unwarranted price and cost increases in the early part of 1937. But, as I shall show in a moment, these increases were due to nonmonetary causes. Certainly the action of the Board of Governors was not designed to increase the interest-rate structure, and in fact it did not materially do so. Nor was the increase in reserve requirements followed directly by a contraction in private credit or a slackening in industrial production. The sharp downturn in production began to develop late in August 1937, or more than three months after the final increase in reserve requirements went into effect. As for private credit, the contraction that occurred did not begin until the end of 1937, sometime after the recession was under way. In other words, the contraction was an *effect* of the recession and not a *cause* of it.

The 1937–8 recession, then, contained few if any elements of credit expansion and contraction. It was due principally to a rapid and speculative building up of business inventories at a time when government spending was drastically curtailed and when consumer income was further reduced by the inauguration of the Social Security law. With swollen inventories on the one hand, and with sharply curtailed consumer purchasing power on the other, a disconnection was formed in the economy that made a deflation inevitable.

Let me amplify this.

From 1933 until the latter part of 1936, an increase in the national income of more than $20 billion had been achieved in an orderly and stable fashion. Nonagricultural prices remained fairly steady and unemployment had gradually lessened. There was also a very substantial increase in private expenditures and in bank credit. Government borrowing to take care of relief, public works, and other programs had put idle deposits to use as well as created new deposits. In 1936, at a time when the government was expending substantial funds on the recovery program, and while private business was also increasing its activity, a soldiers' bonus of $1.7 billion was paid. This increased the cash deficit of the Treasury to more than $4 billion, representing the government's net contribution to consumer disposable income (that is, income after taxes).

While this outlay was being made by the government, there was, as I've already said, a heavy influx of foreign gold throughout 1936. To these two factors there was a further inflationary factor arising from the threat of a war in Europe and from disturbed labor conditions at home. Thus the expectation that the government would continue to pour out money and easy credit, plus increased demands for goods by foreign sources, plus the fear that orders could not be filled because of labor conditions, joined to launch a major inventory boom. There was a general desire in all quarters to convert money into things in the belief that costs of goods were going to rise higher. Many business interests feared they might have difficulty in getting deliveries, so they placed orders not only for current needs but for future ones. This accentuated further the rise in prices, and the speculation in inventories grew to a volume of over $4 billion in 1937.

While this was taking place in the business world, the government in 1937 was *reducing* consumer disposable income by almost $4 billion. This was in contrast with an increase of such income by $4 billion in 1936. The reduction was largely due to two factors. First, the new Social Security law that went into effect in 1937 resulted in a collection of $2 billion in social-security taxes; no part of this was disbursed in benefits. Moreover, the tax pulled potential buying power out of the pockets of the very people most likely to spend the money if it had not been taxed away from them. Second, no soldier's bonus of $1.7 billion was paid in 1937 as it had been in 1936. These combined factors resulted in a $66 million federal cash surplus for the first nine months of 1937 in contrast with a huge deficit in the previous year. Most significant of all, *the consumer disposable income in 1937 contracted by an amount roughly equal to the inventory that had been accumulating.*

To sum up, in the absence of consumer purchasing power upon which the speculative growth of inventories had been based, the inventories were dumped on the market in a drastic deflation, and the conventional pattern of a recession was reenacted.

Was the recession foreseen by those of us who watched economic developments from our vantage points in the Administration?

The answer must be an individual one for each observer.

Speaking for myself alone, I can relate the following:

On March 11, 1937 President Roosevelt invited me to the White House for lunch and a talk about the state of our economic recovery. The mood of the meeting was a mixed one of hope and apprehension, reflecting the mood of a radio address Roosevelt had given a few days before. He had said on that occasion:

Today we are only part way through the program and recovery is speeding up to a point where the dangers of 1929 are again becoming possible, not this week or month perhaps, but within a year or two.

On first glance, it did seem that the recovery movement was secure and that no further positive stimulation was required by the government. After eight years the budget was in cash balance and there were surface signs that our private economic engine had gained sufficient momentum to move forward without the aid of a government tow car. But the other side of the picture—the one that warranted the use of the word "dangers"—was expressed in a memorandum I left with the President, which formed the basis of our conversation on March 11. What I said was by no means unique. Roosevelt probably heard the same sort of thing from many other quarters inside and out of the Administration. And with this disavowal of any monopoly on the theme, I here present the portions the memorandum devoted to it:

The problem now is to maintain the orderly character of the movement that prevailed throughout 1934–1936. This problem threatens to be as difficult of solution as any we have faced. The danger spots are still localized and it would be most undesirable for the monetary authorities to adopt drastic measures, which, if successful, would result in keeping 9,000,000 unemployed. What is needed is a further increase in production and employment, while at the same time preventing inflationary developments from gathering headway in particular industries. This objective can be achieved only by the proper use and co-ordination of all the major activities of the Government affecting business conditions. Unless this is done there is grave danger that the recovery movement will get out of hand, excessive rises in prices encouraging inventory speculation will occur, excessive growth in profits and a boom in the stock market will arise, and the cost of living will mount rapidly. If such conditions are permitted to develop, another drastic slump will be inevitable. . . .

Why the situation is more dangerous than that confronting us in any past revival is attributable to the enormous backlog of demand for the production of durable goods accumulated in the past seven years. At the present time capital facilities in many important lines and skilled labor in others will be deficient to handle the production of durable goods necessary to meet normal growth requirements plus accumulated deficiencies. Steel and machine-tool industries are already working at capacity and this is true of some other lines. It is estimated that the amount of housing that will be necessary each year in the next five years would require an annual amount of building three times in excess of the building in 1936. In many fields, on the other hand, the available supply of labor and plant facilities is sufficient to handle a greatly increased volume of production. The grave danger is that strategically situated industries and skilled trades will capitalize on the scarcity factor to secure excessive wage and price advantages. There is already abundant evidence that this is happening. This means redistribution of real income at the expense of agriculture, unorganized workers, and fixed income groups.

There was no single instrument available to cope with the situation, the memorandum continued. What was required at the outset, was a clear indication that the Administration would not allow the prospects for stability to be jeopardized by excessive and unjustifiable price advances, excessive profits, and unreasonable labor demands. It would use all the power of government then available and would request additional powers if needed to control this unhealthy development.

The luncheon conversation at which this was discussed took place a few hours before Roosevelt left for a Warm Springs vacation. Passing through the press corps at the White House, I was asked to disclose what I had talked over with the President. I said we had talked in general terms about problems such as commodity price increases and labor conditions, but added that I was not at liberty to go into details. The result of even this guarded disclosure was a disquieting one. Joined to an earlier misreading of what lay behind the increase in reserve requirements, financial quarters buzzed with "inside dope" that I had prevailed on the President to support a tight-money policy as a means of curbing the growing price inflation.

In the four days that passed after my meeting with the President, the buzz became a roar and could not be ignored. Though I was not in touch with Roosevelt while he was at Warm Springs, the rumors were so completely contrary to our understanding that a policy of monetary ease was to be continued that I decided to issue a clarifying statement. I did this without consulting the President. What I said might well have brought my term of service with the Government to an end for I pointed an accusing finger not only at businessmen but at laboring groups as well. The statement read in part:

> I wish to correct erroneous interpretations which have been circulated with reference to my position on credit and monetary policies.
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> I have been and still am an advocate of an easy-money policy and expect to continue to be an advocate of such a policy so long as there are large numbers of people who are unable to find employment in private industry, which means that the full productive capacity of the nation is not being utilized. Under such conditions, to restrict the available supply of capital and thus to make it difficult, if not impossible, to employ these people would be not only anti-social but uneconomic.
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> I do not believe that sharp price rises in certain basic commodities should be controlled at this stage of the recovery by a restrictive money policy which would tend to freeze and might bring about an actual reduction in the total volume of employment and production. The price rises to which I refer are the result primarily of nonmonetary factors including foreign armament demands, strikes and monopolistic practices by certain groups in both industry and organized labor. These conditions have in turn led to speculative security and commodity buying which serves to accelerate the price advances.

The remedy for a price inflation when the country has unused manpower, natural resources, and capital is through more, not less, production; through an orderly, balanced use of these three fundamental factors and not by creating a needless, artificial shortage of any one of them.

Soon thereafter the inflated price bubble burst for want of purchasing power to sustain it, and the slump started in earnest.

How was the recession checked?

The answer to this question had its origin in activities that were under way months before the slump began.

Along with others in the Administration I had watched with alarm how new home construction was being priced out of the market. In 1936, 270,000 new home units had been built and year-end estimates made at that time indicated that between 400,000 and 450,000 units would be built in 1937. But by April of 1937 it was clear we would be fortunate if we achieved the 1936 construction figure, let alone exceeded it.

I tried at this time to arouse the President's interest in stimulating new home construction. But he tended instead to place his main reliance for a construction revival on a limited amount of public-financed housing (and a related slum-clearance program) as expressed in the Wagner-Steagall housing bill then before Congress. The bill authorized federal expenditures on the program of $500 million spaced over a period of three years.

This was just a drop in the bucket so far as need went. Moreover, it ignored the basic fact that only through expenditures of private funds on a variety of forms of housing could the economy as a whole as well as the construction industry make any recovery. I was joined in this view by Isador Lubin, the Commissioner of Labor Statistics; J. M. Daiger, who had become the financial adviser to the FHA; and Charles E. Merriam of the National Resources Council. But we could get little additional support for our view so long as the over-all economic picture in the early spring and summer of 1937 seemed favorable.

Following a White House Human Needs Conference in August, we did, however, draft a series of amendments for the FHA which we felt would stimulate certain types of residential construction. I talked to Senators Wagner and La Follette and to Congressmen Steagall and Goldsborough in the hope that they would incorporate our amendments into the housing measure. Wagner and La Follette quickly assented; Steagall and Goldsborough were also in favor of the amendments. But Steagall asked for proof that the President wanted the amendments put into the bill. Accordingly, on August 10, I passed this information on to the President and added:

> Those of us who have considered this matter since the recent White House Conference are satisfied that far more rental-housing construction will take place through private channels under those amendments than the maximum of public housing financed under the Wagner-Steagall bill. But the amendments are needed in order to get this additional private construction, because at the present time an effective financial mechanism for handling rental-housing projects does not exist.

Roosevelt passed the needed word along to Steagall as I had requested, but the rush for adjournment was on when our amendments were introduced as a rider to the Wagner-Steagall bill, and they were ruled out of order in the Senate as not being germane to a public-housing measure. This decided, Congress adjourned.

The business decline started in August and made real headway in September. Few businessmen had correctly interpreted events in the building industry, or the accumulation of inventories on a wave of forward buying, or the unwarranted price increases in commodities such as steel and copper. They ignored the fact that for the first time since 1930 the government in its fiscal operations had deducted as much from the nation's buying power as it contributed to it. The slump that followed was erroneously explained in terms of the Administration's wrong tax policies, as witness the undistributed-profits tax; wrong monetary policies, as witness the orders to increase reserve requirements; and wrong fiscal policies, as witness its program of deficit financing.

While charges of this sort were being raised by businessmen, industrialists, and financiers, a mood of near panic took hold of some highly placed people in the Administration, and with very few exceptions they cast sour looks in my direction and said in effect:

"Eccles has sold us a wrong bill of goods. We bought it at a high price, tried it on for size, and it's brought us into this mess. He argued for an undistributed-profits tax and he got such a tax. He argued the need to increase reserve requirements and they were increased. He argued for a program of planned deficit financing and he got such a program. But now we are in a worse fix than ever before. We've learned to our bitter regret that the economy of the nation can't lift itself by its bootstraps. What we need is capital-goods expansion. That alone can do the trick. But that requires business confidence. And the basis of business confidence is a balanced budget. So we'd better get busy and try to balance the budget as a means of checking the recession."

In the mood of the hour it did little good to note that the undistributed-profits tax that was passed was not the tax I wanted and, in any case, had nothing to do with the recession. It did little good to note that the increase in reserve requirements had not contracted credit, nor had it produced an appreciable change in the cost of money. And it did little good to note that the recession began at a time when the budget *was* in balance!

Though I was rapidly losing the few friends I had and influencing fewer people, I went to Hyde Park in late October 1937 to discuss the economic situation with Roosevelt. The President, at a loss to explain how we had fallen into a recession, was openly searching for a simple and certain way of getting back into grace.

I suggested that an expansion of residential construction would be at least an important aid in checking the deflation.

This could be done by reducing down payments and interest rates on residential construction covered by FHA mortgages. While the President was interested in this simple proposal, he showed no inclination to support it, though he had no objection to my trying to get what I could from Congress, which was being called into special session. The limit of his direct assistance was an offer to call together all government agencies concerned with housing so that a joint housing program could be worked out.

"If you do that," I told him, "you can count me out."

"Why?" the President asked.

"Because the agency heads won't agree." I had in mind, particularly, John H. Fahey, chairman of the Home Loan Bank Board, who would oppose any liberalization of the FHA program.

"What do you recommend?" the President asked.

I recommended that he appoint a small committee whose members would be drawn from circles outside the government and whose support for the housing program would carry weight in the nation as a whole.

The President agreed to this course of action, and on my recommendation appointed a committee consisting of S. Sloan Colt, president of the Bankers Trust Company, New York; Edward F. McGrady, director of labor relations, Radio Corporation of America; Gerard Swope, president of the General Electric Company; Henry C. Turner, president of the Turner Construction Company of New York; and Robert E. Wood, president of Sears, Roebuck & Company.

These men soon afterward met with me at the Federal Reserve Board and there were presented with a tentative plan I had worked out with the assistance of Isador Lubin, J. M. Daiger, and Abner H. Ferguson, general counsel of the FHA. After an exhaustive discussion lasting a day and a half, the committee endorsed a draft plan and agreed to recommend it to the President. The housing plan itself was, in the main, a redraft of the amendments some of us had tried to get the Congress to adopt in August.

In essence, they liberalized mortgage terms so as to induce a greater volume of home construction for both home ownership and rental, while still adhering fully to the sound principle of using private enterprise and private capital to carry out the housing program.

With this object in view, the proposals—apart from technical and clarifying amendments—fell into two groups: (1) those amendments which reduced the down payment to ten per cent in the low-priced housing group, and further reduced the financing cost by extending the maturity date of the mortgages, reducing the interest and insurance rate and thereby substantially decreasing the monthly payment; (2) those amendments which extended the insurance of mortgages to rental types of housing, which were not then adequately provided for under the FHA program.

At the end of the second day devoted to a consideration of the foregoing amendments—the date was November 10, 1937—the committee called at the White House for a long conference with the President. He approved the program we recommended. It so happened, however, that on the same night Secretary Morgenthau, in an address before the American Political Science Academy in New York, came out for a balanced federal budget.

There had been persistent rumors that he would do this, but I hoped it was only a temporary phase in his thinking. I was baffled when it proved otherwise, and not so much because of what Morgenthau said, but as an index to the President's thinking. I did not know whether Roosevelt approved Morgenthau's stand, yet the past history of their relationship indicated that Morgenthau did very little without first consulting the President. This being so, the views he expressed in New York could be construed to be Roosevelt's views also.

But if this was so, then other things became inexplicable. A meeting had been held in the White House on November 8, two days before the Morgenthau speech, when the causes and the cures of the recession were thrashed out in detail. On that day the pattern of the discussion was provided by a now famous memorandum prepared by Isador Lubin, Leon Henderson, and Lauchlin Currie, indicating how a reduction in government spending had helped precipitate the recession. There were indications that Roosevelt was impressed by the argument advanced to him. And then at the White House meeting of November 10, at which he approved the amendments to the FHA, he seemed to agree that the housing proposal was not the only lever by which the economy could be revived. We also needed a resumption of government spending and not a curb on it.

The contradictions between the afternoon and evening positions made me wonder at this time whether the New Deal was merely a political slogan or if Roosevelt really knew what the New Deal was. This is an ungenerous comment, yet it faithfully reports what I felt at that time. As I now reconsider the event, it seems clear that the President assented to two contradictory policies because he was really uncertain where he wanted to move.

Soon after the special session of Congress convened, the President asked that I have prepared a draft of a message he could send to Congress incorporating the proposed housing amendment on which he wanted action. The draft was used with but a few verbal changes and was sent to Congress on November 27. It proved to be a popular message. Even the *New York Herald Tribune,* which in those days took a dim view of anything with which I was connected, relented long enough to describe the proposed measure as "the soundest piece of economic legislation to come out of the White House." The earlier success of FHA operations at slight cost to the government had created an aura of goodwill for the proposed changes. House hearings before the Committee on Banking and Currency, with Congressman Steagall in the chair, began on November 30 and were disposed of in eight days. Senate hearings began on December 1 and also ran eight days under the direction of Senator Robert J. Bulkley, chairman of the subcommittee to which the housing bill had been referred.

By December 17 the House committee had voted to report out a housing bill that followed the major particulars of the President's housing program. But then in the Senate committee a last-minute development took place that threatened the whole effort to stimulate new construction. On the face of things, it was a "pro-labor" development. It was the advocacy of an amendment by Senator Bulkley requiring that any mortgage contract issued pursuant to Title II of the FHA should contain the prevailing-wage clause. This is the clause ordinarily provided for in legislation dealing with public contracts or publicly financed construction. But if the Bulkley amendment was adopted, it would destroy the effectiveness of the proposed legislation, primarily because there would be no lenders.

They would not make loans under the FHA setup if they had to face the constant risk that the loan might be suddenly invalidated because it was discovered that builders, contractors, and subcontractors had not paid the prevailing wage to their labor force—even assuming the prevailing wage for every community in the land could be officially determined. As far as the FHA was concerned, Congress might as well vote to repeal the act as to make its continued operation depend upon a condition that the FHA had no means of enforcing.

Senator Wagner, chairman of the Senate Banking and Currency Committee, was presented with this problem. He understood and agreed with our contention that the prevailing-rate amendment should be kept out of the Senate version of the bill. On the other hand, as one of the foremost spokesmen in the Senate on behalf of labor, he did not want to be placed in the position of having to vote against the amendment if it was proposed on the floor of the Senate.

In an executive session of the Senate committee Senator Wagner candidly stated his plight to all members. He explained the great political embarrassment it would cause if the prevailing-wage clause came to a vote on the floor. On the other hand, if the prevailing-wage clause was written into the bill, then the hoped-for revival in the housing industry through expanded FHA activity would prove illusory. Having in the meantime prevailed on Senator Bulkley to withdraw the amendment, Wagner secured what he thought was an understanding from all other committee members, Republican and Democrat, that they would not introduce the amendment on the floor of the Senate. That this was generally understood is indicated in the fact that the bill reported to the Senate by the committee did not contain the prevailing-wage clause, nor was there any minority report of any sort.

It was hoped that with this show of unanimity in the committee the Senate as a whole would give swift approval to the measure and it would be put into final shape for passage by Christmas. But then, suddenly, Senator Henry Cabot Lodge rose on the floor of the Senate and interjected the prevailing-wage issue into the debate. Senator Lodge was a member of the Senate Banking and Currency Committee, and I'm told was present on the day Senator Wagner went around the table and asked each committee member whether it was understood that no one would introduce the prevailing-wage amendment.

Senator Lodge's action in the Senate took everyone by surprise. Apart from the embarrassment it caused Senator Wagner, if the amendment Lodge was prepared to offer in his guise as a friend of labor had passed, it would mean that FHA operations would come to a standstill and tens of thousands of workers would be thrown out of jobs. No one in the Senate seemed to know what to do next, except to get the whole housing bill off the floor at once so as to avoid a need for further discussion of it. Finally, after some heroic work by Majority Leader Barkley, enough votes were rounded up to send the bill back to the committee, it being understood that a prevailing-wage amendment would be "considered" by that group. There matters rested until after the Christmas holidays.

In the meantime a somewhat similar situation developed in the House. Here a Congressman from New York City who also made much of being a friend of labor let it be known that he was going to introduce a prevailing-wage amendment to the housing bill once it reached the floor of the House. J. M. Daiger, who was following the legislative course of the bill for the Administration, tried to dissuade the Congressman from doing so.

In need of a helping hand, he got in contact with builders and contractors in the district represented by this Congressman. An appropriate delegation came to Washington and, with Daiger as shepherd, called on the Congressman about half an hour before the housing bill was due to reach the floor of the House. Daiger went into the private office of the Congressman to make one last rational plea with him.

As he re-emerged into the anteroom, he was asked: "What does the Congressman say?"

"He says he's going ahead with his amendment," Daiger replied.

At this point a contractor in the delegation shouldered his way forward and said: "I'm going in to see him."

Later, when the Congressman failed to show up in the House of Representatives, it was learned that he had unfortunately and suddenly been taken ill.

Congress ultimately passed the housing bill after the Christmas recess without the prevailing-wage provision that had earlier delayed matters. The measure itself was the only part of the President's economic program adopted by the special session. In the face of a deflationary tide, the volume of new housing the bill initiated was very substantial. But the fact that it proved an effective stimulant to new home construction in a time of depression in no way justified further liberalization of FHA terms under postwar inflation conditions. Those of us who shaped the first FHA Act and then the amendments that were designed to stimulate recovery expected that its terms would be *restricted* and not relaxed further as they have been in postwar years. Such relaxation has greatly added to the postwar inflation, particularly in the construction field.

While the Congress was putting the finishing touches on the new housing bill in the first part of January 1938, I was called to the Capitol once more to give public testimony. The forum this time was the Senate Committee on Unemployment Relief, with Senator James F. Byrnes as chairman.

The committee had been set up to investigate the causes of the slump and to gain opinions on what could check it. I was informed that I might be called before the committee at some stage of its work. On January 3, one day before the hearings began, Senator Byrnes reached me by phone to say that I was to be the opening witness. I do not know the reason for this sudden switch. It might have been due to the Senator's love of drama, for by this time, the opinion had jelled in other quarters that the increase in reserve requirements ordered by the Federal Reserve Board in 1937 had been responsible for the slump. In fact, hardly a day passed when someone in Congress or an eminent leader of the financial and industrial community did not demand that I be removed from my post. I suppose, therefore, I made an interesting public exhibit.

I told Byrnes I would need more than the minute's notice he gave me in which to prepare my testimony.

To this he replied: "If you are not prepared at all times to discuss this subject, you shouldn't be the head of the Federal Reserve Board."

"That's true enough," I said, "but if I'm to come before your group and speak off the cuff, I might make statements that would offend the Treasury Department and all others who are pressing for a balanced budget."

"Come anyway," he said.

"I'll come," I replied, "only on condition that you make it perfectly clear at the outset of the hearing that I am not a voluntary witness—that you dragged me before your group."

Byrnes kept his word, as evidenced by the opening remarks he made on the following day when the hearing began. The record reads:

> *The Chairman:* I want to say to the members of the Committee that I had asked Governor Eccles of the Federal Reserve Board to appear on Friday of this week, and only yesterday afternoon requested him to appear today. Mr. Eccles did not want to come at any time. I did not have to resort to sending him a subpoena to bring him here, but at one time I thought I would have to do it. He is not only reluctant, but is a very recalcitrant witness. Nevertheless, he is here.

I came to the hearing without a formal statement and spoke extemporaneously. I stated the doctrine of a compensatory economy and how its orderly operation had been gummed up by the combination of factors I've alluded to already in the list of things that brought on the recession of 1937–8. As I moved through this account, several Senators tried to twist my words into caricatures of their true meaning, but I believe the record shows that I managed to state my own position and not theirs.

There was a tense moment when Senator James J. Davis of Pennsylvania challenged one of my statements regarding the way excessively high labor costs in the building industry had contributed to the recession. Davis, who had been Secretary of Labor during the terms of the last three Republican Presidents, seemed to feel that I was anti-labor. Accordingly he asked:

"How do you determine that the building labor [sic] is asking too high hourly rates and pay?"

"Because," I said, "no one will buy their services. That is the best evidence of that."

There was a long pause while Davis regrouped his forces.

In the course of this testimony I was also forced to challenge the budget-balancing philosophy Secretary Morgenthau had advanced on November 10 before the Academy of Political Science. In this connection the record of the hearing reads:

Mr. Eccles: You can only balance the budget out of increased national income. I am as favorable as anybody could be to the objective of a balanced budget, and over a year ago I was advocating the need of approaching a balanced budget. However, I think that at this time to try to balance the budget either by substantial reduction in expenditures, or by increasing taxes, would be deflationary; and that it is not so much what the total debt of the Government is as it is the timing of the increase of the debt. In other words, assume that in 1936 there had been no debt at all, and, therefore, it would have been said that the Government could well afford to spend five or ten billion dollars. Nevertheless the spending at that time would have been very bad [because of inflationary developments then under way].

While some sort of gentleman's agreement between unions and contractors was reached in the early months of 1938 regarding voluntary cuts in construction costs, with a consequent increase in new construction, the task of turning the deflationary tide required a resumption of government spending as well as an expansion of private spending. Morgenthau's attempt to balance the budget, for all its grand intentions, had made matters worse and not better.

By March 22, 1938, when Roosevelt left for a Warm Springs vacation, a few business leaders had begun to intimate in guarded terms that they were not averse to planned government deficits. Though they refused to acknowledge the fact openly, they seemed at last to have grasped some understanding of the relationship between their prosperity and the rate of government spending: the national income was dropping at the rate of $800 million a month. At this time, too, the financial community, which vigorously fought financial reforms such as the Securities Exchange Act of 1934, the Banking Act of 1935, and deficit financing of any kind, was put on the defensive when the blue-stocking firm of Richard Whitney went bankrupt under conditions that led to Whitney's imprisonment. (At the time this happened, Whitney was also president of the New York Stock Exchange and a leader of financial forces opposed to reform.)

Harry Hopkins, who had been most active in earlier months in urging a resumption of deficit spending, was in Florida at this time, recuperating from a critical operation. While there, he seemed to sense that if he once again pressed the President for action along the lines indicated he might get a favorable answer. He was to join the President at Warm Springs, and en route there he stopped off at Atlanta and summoned to his side Leon Henderson, Aubrey W. Williams, and Beardsley Ruml. Together they worked out once again the whole case for planned deficit spending. Armed with this memorandum, Hopkins proceeded to Warm Springs for his meeting and discussions with Roosevelt. By April 2, when the Presidential train was headed back to Washington, with Hopkins aboard, the whole of the budget-balancing program had been scrapped.

The nation was informed of that fact on April 14, 1938, when Roosevelt sent a message to Congress in which he asked for a resumption of large-scale spending. Equal in importance to his request were the reasons he advanced for it. They were drawn from the principles of a compensatory economy, which some of us had been urging with only variable success for many years. In all those earlier years, and in particular during 1936 and the first part of 1937, men around the President could create doubt in his mind by saying that recovery would have proceeded without the support of government spending. But it took the sharp slump of 1937 to clear the air so that matters appeared in their true light.

The appropriations that Congress authorized, combined with measures such as the new stimulus to construction obtained by the liberalized FHA program, the liberalization of bank-examination procedures, and the desterilization of gold, helped check the recession. The first signs of a gradual reflation of our economy became noticeable toward the latter part of 1938, though not unmistakably so until 1939.

But, paradoxically, the first promise of success brought a demand that the instrument that helped gain it should be blunted. On December 10, 1938, in an address given in Boston to the Massachusetts Taxpayers Federation and broadcast over the nation, Senator Harry F. Byrd of Virginia demanded an end to "nine years of fiscal insanity" and declared he was convinced the Roosevelt Administration could not be looked to for leadership in any economy program even though it saw that its spending program had been a "tragic failure." He paid his compliments to my own economic philosophy and declared it indicated "to what depths of false reasoning we have sunk in the crackpot legislative ideas of those holding important public positions."

The remainder of Senator Byrd's address was a blend of vitriol and popular aphorisms. It gained widespread praise and was also a shrill overtone of similar sentiments held inside the Administration by such highly placed figures as Vice President John Garner, Secretary Cordell Hull, Jesse Jones, Senators James Byrnes and Pat Harrison. Though I had been singled out for special attack by Senator Byrd, what mattered most of all was his misstatement of economic truths. I felt it imperative that his distortions should not go unchallenged. Accordingly, I drafted a letter of reply to him and took the copy to the President. I explained that I wanted the letter to be of the sort that would make the front pages; that I was quite prepared to face any personal consequences of the fight I was inviting.

The President was delighted with both the plan and the letter. In fact, he became apprehensive when a week or more passed after I saw him and I had not yet released the text to the press. He called me on the phone and without any preliminaries said: "Marriner, what's happened to that letter? You're not backing down, are you?"

I assured him that the delay was not due to cold feet. I had simply overlooked the fact that the Federal Reserve Board, on December 23, was to unveil a commemorative plaque to Senator Carter Glass. Under the circumstances, I felt it would cause some embarrassment to assail the junior United States Senator from Virginia while immortalizing the senior one. It seemed best to have the unveiling ceremony out of the way first and then attend to current affairs. Roosevelt roared with laughter when I explained the delay in these terms, and he approved of the proposed agenda.

Two days after the plaque to Senator Glass was unveiled, I unveiled my letter to Senator Byrd. It is a long letter, and yet I feel it should appear here in substantial detail, since it summarizes the greater part of my economic philosophy as publicly expressed up to this point. It reads in part:

I think I may be forgiven for feeling some impatience when a responsible public official like yourself so misconstrues my viewpoint as to make it appear that my advocacy of properly directed and properly timed Federal expenditures, for the primary purpose of stimulating private enterprise, is based on any other principle or purpose than to aid in bringing about the greatest possible degree of sustained employment and production of real wealth by private activity and enterprise, which, in turn, is the surest safeguard of our democracy as it is of the solvency of our Government. Only in this way, by restoration of national income, can we reach and maintain the balanced budget which I am as desirous as you are of achieving. You have every right to disagree as to the efficacy of fiscal, monetary, and other policy in effecting stimulation in depression or retardation in a period of unsound expansion. I, of course, reserve the right to present the other side of the case. But I am convinced that it deserves consideration on its merits, without rancor or misrepresentation.

You appear to believe that a large part of the Government's expenditure is "waste." You are fearful about the Government's credit and alarmed about the "burden" put upon the country by the public debt. There is not space within a letter adequately to discuss these matters, but in view of your program and since you saw fit to make a personal attack upon me, I feel that it is in order to raise a number of questions with respect to each of the foregoing considerations.

As to the "burden" of debt: the pertinent facts are the volume of total debt in the country, the interest on that debt, and the income out of which interest may be paid. You failed to mention any of these pertinent facts. Are you aware of studies made by a distinguished group of scholars, under the auspices of the Twentieth Century Fund, indicating that the total of all domestic debts, both public and private, is no greater today than it was in 1929? That being so, does it not give a one-sided and alarming picture of the country's debt situation to concentrate attention solely upon the increase in the public debt without regard to the contraction of private debt, and without regard to the increase in population and in the material wealth of the country since 1929? Is it of no significance that, owing to the decline in the rate of interest, the total of interest payments today is far less than in 1929?

As to your concern about the burden of taxation, have you not overlooked the fact that as national income increases, tax revenues increase, even without a rise in tax rates? National income increased from less than $40 billion in 1932 to approximately $70 billion in 1937. Tax receipts of the Federal Government increased from $2,080,000,000 for the fiscal year ending June 30, 1933, to $6,242,000,000 for the fiscal year ending June 30, 1938. The country paid about $4 billion more in taxes but it had $30 billion more of income a year out of which to make these payments. Would you have the public believe that the country was better off in 1932 with lower taxes and a lower public debt than it was in 1937 with higher taxes and a higher public debt?

So much for the debt "burden." Turning to the question of what is to be entered upon the credit side of the ledger as an offset to the increase of the public debt, you evidently contend that nothing is to be entered; that the Government's expenditures, for which the debt was incurred, represented "waste."

Is it "waste," as you seem to think, to have the Government borrow and put to use otherwise idle funds of individuals and corporations? Is it "waste" to have the Government, by borrowing from the commercial banks, replenish the supply of bank deposits which contracted by one-third because of debt liquidation during the deflation, and put this newly created money to work providing employment and thus utilizing man power and productive facilities that otherwise would have remained idle? Is it "waste" for the Government to expend these newly created and these otherwise idle funds for roads, dams, bridges, school houses, hospitals, and a host of other useful and necessary things that are needed by the community but are not supplied by private enterprise? Are these additions to our national wealth, additions resulting from public expenditures that are based upon increase of public debt, more "wasteful" than the expenditures in the late twenties, based upon private debt, whereby billions of dollars were diverted to uncollectible foreign loans and to build at inflated prices huge skyscrapers, office buildings and apartment houses, many of which never have been sufficiently occupied to maintain the investment?

Early in your speech you extolled . . . "those time-old virtues of thrift, frugality, self-reliance and industry." Somewhat later, however, you expressed alarm at the increase in debt of the last five years. I am at a loss to understand how you reconcile these two ideas! Certainly if it is good for people to save, i.e., practice the virtues of thrift and frugality, it must also be good that someone should borrow money and put it to productive uses. Private enterprise has in the years since the depression began been in no position to employ profitably anywhere near the total of the country's savings, because there was not sufficient buying power in the hands of the public to purchase the output of existing facilities of production.

Debts and obligations of various kinds are but the other side of investment, and if we ever tried to liquidate the whole amount of them, or even any substantial fraction, we would precipitate a crisis so severe that general economic paralysis would result. When there is contraction of total debt, private and public, we have deflation. We have never had prosperous conditions without an accompanying expansion of debt, either private or public, or both.

Do you think, as your speech seemed to indicate, that in a democracy the Government has no responsibility for creating debt in order to give employment at times when private indebtedness is contracting and private enterprise is unable to do so? Do you consider, as your speech implies, that government debt is evil, whereas private debt is not? One would gather from your attitude that if a private builder, for example, borrows money to build houses you would commend him for "raising capital for private enterprise," whereas if a public housing authority borrows money for the same purpose, you would denounce it for "incurring debt."

You stated that you are concerned about "the character of the individual citizen" and "the dignity and the rights of the individual." So am I. I believe, however, that the most basic right of all is the right to live, and next to that, the right to work. I do not think empty stomachs build character, nor do I think the substitution of idleness and a dole for useful work relief will improve either the dignity or the character of the people affected. We cannot expect to preserve our free institutions in this country if we condemn a substantial proportion of our people to prolonged idleness on a bare subsistence level of existence. Further than the right to eat and the right to a position, I think the individual, whether rich or poor, has a right to a decent place to live. I think he has a right to security in old age and to protection against temporary unemployment. I think he has a right to adequate medical attention and to equal educational opportunities with the rest of his countrymen. The government expenditures which you condemn have in large part been the means of translating these basic rights into realities.

I am convinced that if your program of sudden, drastic retrenchment were followed, we would witness another sharp reversal and renewed deflation. And I, for one, am not prepared to believe that this nation is doomed to stagnation, to a low level of national income, to a wholly unsatisfactory standard of living instead of the high standards, the achievement of which depends only upon our correct understanding of the operations of our economic system. I am convinced that your program is not only a defeatist one, a program of retrogression and not of progress, but that it would jeopardize the salvation of our democracy, which I know you are as sincerely desirous of preserving as I am.

The uproar in the press following this letter was highly gratifying, though hardly any editorial writers agreed with me.

Senator Byrd's reply was held up while we all enjoyed the Christmas season of peace on earth, good will toward men. But on January 16, 1939, with the Christmas moratorium ended, the Senator returned to the attack. The pellets in the buckshot spray he issued on that day were drawn from *Poor Richard's Almanac*, *Bartlett's Quotations*, Will Rogers's aphorisms, condensed versions of the lives of Thomas Jefferson and Andrew Jackson, and the history of the Federalist Party, and of the English people in modern times.

Though I was somewhat baffled by the character of this reply, it was not unexpected. I felt that what Byrd said would be repeated many times over by like-minded men. The provocation to do so was offered them by the President's State of the Union message and budget messages presented to Congress in early January 1939. Those messages for the first time formally and frankly declared the Administration's intention of balancing the budget out of increased receipts arising from an increase in national income rather than by sharply decreasing expenditures or increasing taxes on consumption; they declared that federal deficits could be expected until such time as the budget could be balanced out of a national income of around eighty billion dollars. Following delivery of those messages, I wrote to the President on January 11 to say in part:

It is the greatest importance, I feel, that others holding important positions in the Government, particularly in the Cabinet, should participate in a program of presenting your case to the country. Most important of all, is such a presentation authoritatively made by the Treasury, which, I understand, has accepted the objective of an $80-billion national income as the means of balancing the budget. If the Secretary of the Treasury were to make a public address very shortly explaining the soundness of this case, it would pave the way for others to follow this up.

Until the Secretary of the Treasury makes a speech, it would seem to me inappropriate for the rest of us to attempt to lead out in this field which is so predominantly the Treasury's responsibility. Once he has presented the case officially for the Administration, it will be much easier for the rest of us to follow up, acting under his leadership and avoiding the appearance of dissension within the ranks or encroachment upon the Treasury's domain.

This plan of action did not materialize. Presidential bees had begun to buzz at this time, with the result that many important leaders in the Administration became extremely cautious about what they said and did. Thus at the very moment when Roosevelt most forcefully subscribed to the doctrine of a compensatory economy, some of the men who urged him to that course of action left him in an exposed position while they courted those who could help their personal political fortunes.

Under these circumstances it was, I felt, somewhat ironic that, as a child of the Republican Party, I should undertake the defense of a Democratic President's views when his close political associates were running up neutral flags. My associates on the Board of Governors strongly opposed my getting any further involved in a counterattack on the views expressed by Senator Byrd. They said that I would drag the whole Reserve System into a partisan political fight and thereby destroy its role as an independent agency. To this I replied that I should continue to join issue with Senator Byrd—not for the sake of defending the political fortunes of the President, but to defend the economic ideas that had brought me to Washington and kept me there so long. Furthermore, in doing this, I would try to make it clear that I was expressing my own views and not those of the Board.

Accordingly, when the National Broadcasting System invited Senator Byrd and me to engage in a radio debate, I accepted the invitation to do so, as did he. He spoke first, on January 16, the evening of the day on which he sent me the letter alluded to earlier; my radio reply came one week later, on January 23. Like his letter, Byrd's radio address represented an obscure target. He denounced the government's spending program, denounced my ideas, called attention to the staggering burden of debt that would be passed on to future generations, declared that "waste and extravagance" should be cut out of government spending. But it was extremely difficult to abstract from this volubility a specific set of economic propositions to which one could reply. In so far as that was possible, the reply to him followed the general theme of my earlier letter. One extract alone needs be presented here. It reads:

As to the burden of the government debt on our children and our children's children, which also disturbs the Senator, if they reduce the national debt it will probably be because their national income justifies the reduction, and it will be no more of a burden on them than was the reduction of nine billions of the war debt during the twenties. In fact, we could have paid off much more of the war debt if we had not had three major income-tax reductions which helped to encourage stock-market speculation and the making of uncollectible foreign loans.

Why not worry also about the burden of all of the private debts on our children and their children, because these debts will also be passed along to future generations, who will have to pay the cost of servicing or paying these debts just as in the case of the government debt. We should know that all debts, both public and private, are passed along from one generation to the next, just as all assets, both public and private, are handed down from one generation to the next. It may be that Senator Byrd would be less worried if there were no debts, but in that case there would be no banks, insurance companies, or other financial institutions.

The Senator has warned you that the total debt of all public bodies in the United States now amounts to $430 for every man, woman, and child, that it is a mortgage on you and your property, and that your children and grandchildren will have to pay off this mortgage. But he failed to tell you who owns the mortgage. You, of course, know that it is owned by all of the people and amounts to an average of exactly $430 owed to every man, woman, and child. In other words, all of the people are borrowing through their public bodies from all of the people.

The whole problem of internal debt, public and private, must be considered in relationship to the total real wealth of the nation. Our total debts are great or small, depending upon total national income. The British public debt a century ago was equal to $4 billions. At the present time it is $40 billion, or ten times greater. Their debt has grown, but the income of the British people has grown much faster than the debt. While doubtless it would be better for them if they had less public debt, it cannot be said that the debt has either bankrupted or impoverished the British nation, because their standard of living has increased during this entire period.

Now make no mistake, I am not advocating ever-increasing debt, but I am merely pointing out that we should see the problem of debt in its true perspective. I do not think that alarmist talk about it is calculated to help recovery or to induce private capital to go to work.

(Parenthetically, I've always agreed with Senator Byrd on the need to receive a full measure of value from all government expenditures made under any conditions. Whether in time of depression or prosperity, waste, inefficiency, and useless expenditures are indefensible. But the heart of our disagreement in the prewar period was on the kind, rate, and scope of government spending as a device to achieve and maintain maximum production and employment. With the development of postwar inflationary conditions, and particularly since the beginning of the new defense program, I find I am now in substantial agreement with Senator Byrd, though he does not appear to have changed his economic philosophy; it is the same in periods of inflation or deflation. Now that we are in an inflationary period, the logic of the compensatory economy to which I subscribe leads me to agree with Senator Byrd that there is a great need to curb inflationary developments through a vigorous government economy program in non-defense expenditures, to scrutinize all defense expenditures closely, and then to levy necessary taxes to put the federal budget on a pay-as-you-go basis.)

I had not yet left the radio station after the broadcast when a call came to me from the White House. Steve Early was at the other end.

"Marriner," he said, "I want you to know how much the boss appreciated your speech. Here you are, with much less reason to stand up for him than many others, yet you were the only one who did it."

On the following morning there was another phone call. I at once recognized the President's voice.

"Hello," he said. "How are you this morning, Marriner?"

"Fine," I said.

"Well, I just called to *condemn* you and to *commend* you. I want to condemn you because you kept me up late last night. I usually go to bed at ten. But you kept me up until ten thirty listening to your speech. But now I want to commend you. I think your address was excellent. You made the problem so simple that even I was able to understand it."

Still, the political pressures that had forced members of the Roosevelt Cabinet to lose their nerve in the face of demands that the budget be balanced continued to mount. By this time I, too, had wearied of talking without any seeming effect. And so on March 23, 1939 I took a new tack. On that day I had been called before the special committee investigating silver policies. Throughout the morning of the hearing I had been put on the defensive trying to justify the concept of a compensatory economy. For their part, the investigators phrased their questions so as to make a case for increasing the price of silver as well as for bimetallism. These were to be substitutes for deficit financing. During the recess I decided I had had enough of the defensive role and accordingly prepared the following statement, which I read to the committee when it convened in the afternoon:

Another school of thought believes that business confidence cannot be restored until a balanced budget is assured through reduction of government expenditures, that continued deficits are holding back private investment, that government employment is demoralizing and destructive of the moral fiber of our people, that the public expenditures are wasteful and are piling up a burden of debt which our children and grandchildren will have to pay off. Senator Byrd has stated that he believes that for every dollar the government borrows and spends private enterprise is deterred from spending two.

A similar viewpoint has been expressed by the United States

Chamber of Commerce, by stockholders, replying to a questionnaire sent out by the National Association of Manufacturers, by the New York State Bankers Association, and by the American Institute of Steel Construction, representing an important element of heavy industry. It is not too much to say, in fact, that this appears to be the prevailing point of view among business men and the public generally, as reflected by a recent Gallup poll, by innumerable resolutions of trade associations, by bankers' groups, and—as I can testify from personal experience—by the overwhelming majority of newspaper editorials.

A great majority of people appear to believe, therefore, that business confidence would be restored if the budget were balanced, and that the spurt of economic activity that would result would accomplish our common aim of recovery. It would appear that the majority of the business leaders on whom would fall the task of producing the activity necessary to recovery are convinced that the government's expenditures compete with and discourage private investment in existing and new enterprise. A majority in both houses of Congress have indicated that they also hold this view. While I am convinced that such a policy of retrenchment under present conditions would have disastrous results, we live in a democracy and, therefore, I believe that the viewpoint of the majority should promptly be made effective.

The country is entitled to a clear-cut and prompt determination of policy on this vital issue. Uncertainty and hesitation do not contribute to recovery. It is Congress that determines the rates and nature of our taxes; it is Congress also that determines the amount of government money to be used for different purposes. If balancing the budget will bring about recovery, then Congress can promptly do so by reducing expenditures to the level of receipts. If, in addition, taxes were to be revised and cut as a further inducement for private enterprise, government expenses could be reduced still further to make up for the decline in tax receipts.

In order to effect sufficient economy and reduce taxes, Congress would have to reduce substantially practically all of the large items in the budget. Not much economy could be effected in the regular establishments of the government, which in the aggregate absorb only about one tenth of the national budget. Such items as work-relief projects, CCC camps, roads, and public works of all kinds, veterans' benefits, all farm-benefit payments, and national defense, some or all of these would have to be drastically curtailed.

This would not be my program, but if, as would appear, it is the program of the majority, they should assume full responsibility for it and put it into effect without delay and without compromises for the benefit of any special groups.

The reaction to the statement took the form of a long sputter. Some of the budget-balancers quickly explained that they had never insisted on an immediate balancing of the budget. Others charged me with "political trickery" and "low political cunning." The more generous among these critics said I was "naïve." Others among them tried to put a bold face on things and challenged the Administration to join Congress in instituting drastic economies. And so on and so on in a dialogue heard to this very day every time Congress is challenged to reduce expenditures.