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RESEARCH REPORTS

Foreword

This organization judges, not men, but the effects of the acts of men. We must concentrate attention on the results to be expected, ignoring the intent of the individuals involved. What men hope for and intend to achieve furnishes a clue to their characters, but our duty here is obviously to put aside all such considerations. Intentions, good or bad, are like dreams which fade from the consciousness of another day. But the means chosen by which it was hoped to carry out these intentions, the definite action taken, must have concrete results. They are the future.

Coming Effects of Current Events

Because monetary changes affect nearly all economic activities, they are of primary significance. No business that is operating on other than a crude barter basis can escape the effects of subtle alterations in its medium of exchange.

What the President Did Not Say Those who were anticipating definite information regarding the administration's plans for the future of the dollar were disappointed. So likewise were those who hoped for promises to balance the budget. Therefore, the door has been left open for such money juggling as may be deemed expedient in the future. It follows that the benefits of sound money will not be forthcoming in the months immediately ahead. The normal resumption of long term investment in private enterprises will be retarded and whatever recovery there may be will not rest on the secure foundation of balanced progress.

Inflation via Budget Deficits Failure to balance the budget means further credit inflation. Treasury notes and bonds will be sold to the banking system in order to get the credits (increased checking accounts) which the Treasury can use to pay its obligations. The banks have no new savings to invest in such securities inasmuch as time or savings deposits have increased little if at all for more than a year. Therefore, the banks must create new purchasing power in the form of increased demand deposits to pay for government bonds.

The Bond Salesman During the "new era" which ended in 1929, bond salesmen were notoriously over-optimistic, possibly even to the extent of overlooking certain unsound practices which lowered the value of their securities. It is interesting to note, therefore, that one of the standard sales arguments of that unfortunate period has been revived by the President. The plea for confidence in the house of issue is a poor substitute for proper analysis. The President urged the bankers of the country ". . . to renew their confidence in the people of this country. I hope you will take me at my word." No doubt, the practical effect of this adroit super-salesmanship will be to facilitate the process of loading the banks with government bonds.

Silver Remonetization Inflation via the silver remonetization scheme proceeds at a slow but impressive rate. With silver futures above 55 cents, the Treasury buying program continues. This is definitely inflationary even though the rate of making new purchases is so gradual that no striking results can be seen at this time.

More Bad Banking The country's commercial banking system has been justly criticized for its failure to distinguish between the legitimate needs of business and long term loans and investments for which savings alone should be used. The last great boom was made possible by unsound banking, by the violation of principles which have been forgotten again and again in the history of banking, always with the same disastrous results. It is interesting to note, therefore, the advice from governmental sources. Recently, the chairman of the Reconstruction Finance Corporation has urged the banks to make loans ". . . that will need to be indulged," loans that they are willing to carry for several years. In other words, the commercial banks are being asked to put themselves in the same frozen condition which was largely responsible for our troubles of the past few years.

The Spending Spree The latest program of spending contemplates pouring out $200,000,000 monthly for the next five years. This is only one-half the rate proposed by the country's unofficial English advisor, Dr. John Maynard Keynes, but it is presumably in addition to the expenditures which will be made for direct relief. The source of the funds will probably be new bank credit, created especially for the Treasury in exchange for long term government bonds. The announcement, which was somewhat vague as to details, followed a few days after the President's "pep" talk to the bankers. Unquestionably, the banks are expected to fund the Treasury deficits indefinitely, and the question arises whether or not they will continue to do so. Probably they will for some time to come. In the first place, the banks are heavily loaded with government bonds now and will be under pressure to support the market value of their principal asset. Secondly, they are faced with more direct political control and possibly a government central bank if they refuse to show their ". . . confidence in the people of this country" by buying the people's bonds. It is reasonable to conclude that the spending spree will continue and that the source of funds will be new and inflationary bank credit.

Plucking the Blue Eagle's Feathers?

It has been reported that a change of certain NRA policies is under way. Restrictions upon output, and price-fixing, except in basic commodities, are no longer regarded as panaceas for the ills of business. The discovery has been made that a high standard of living is dependent upon a large volume of production, that goods not manufactured cannot be consumed. It is encouraging to know that some of the elementary principles of economics are not beyond the grasp of governmental authorities, even though it has taken more than a year for this simple truth to find acceptance.

Price-fixing as a remedy for sick businesses has been tried so often in the course of business history, always with unfortunate results, that it is difficult to imagine how it ever gained a hearing before a "brain trust." To a great extent, the industrial development of the past two or three centuries has been due to the freeing of business from shackles imposed by misguided governments and guild (or code) authorities. Although the retail prices of many articles were raised by operation of the codes, it does not seem probable that abandonment of price-fixing provisions will result in widespread price cutting and declines to the levels of two years ago. We are in a period of rising prices, of adjustment to a new weight of the dollar, and inflation is definitely in progress. These factors insure that price declines will be limited to those articles where the initial price raising processes under the codes were carried to violent extremes. No general fall in the price level is to be anticipated.

Supply, Demand, and Prices

It is true, of course, that in the long run, demand for some goods is no more nor less than the supply of other goods. Underneath the complex interrelationships of modern commerce, the fundamental process of exchange remains the same. Once direct barter has been abandoned in favor of modern monetary and credit processes, however, the means have been provided for wide discrepancies between supply in the form of goods and demand in the form of dollars available to willing buyers. Price fluctuations reflect lack of balance between the money resources of willing buyers and the original quotations of the hopeful sellers.

Supply or Production It is not strictly true that general industrial activity is a measure of the supply which will soon appear in the market place. A large portion of the production reflected in the New York Times Weekly Index of Business Activity, for example, is not for the retail market and much time as well as several manufacturing processes intervene between the production of today and future offerings of consumption goods. However, such an index is perhaps the best available guide to the supply conditions of the near future. From June to September, industrial production was definitely on the down grade. The decline was roughly 15% in the short space of three months. This has naturally given rise to fears that a resumption of the deflation process has begun, that a decline to depression lows, or worse, may be expected.

Demand In spite of the decline in basic activities, retail purchases have been maintained at a more satisfactory level. Mail order sales for the third quarter of 1934 were nearly 8% greater in the corresponding period of 1933. Registrations of automobiles exceeded production by 3% during the last three months of this year whereas the reverse was the case in 1933. Of even greater significance is the fact that demand deposits (checking accounts) have been rising almost steadily for more than a year. The injection of new purchasing power into the channels of business by the inflationary means already discussed is making possible future demand of enlarged proportions.

Prices Apparently, the decline in production of the past few months has run its course. Sustained consumer demand has somewhat reduced inventories and new supplies of goods must be obtained for the retail markets. The upturn in basic production will provide somewhat greater employment and to this extent the unfavorable effects of the last quarters' declining rate of industrial activity will be reversed. Furthermore, the government's spending program continues and new purchasing power which will shortly become demand in the market place is constantly being created. No further substantial decline in prices is to be expected from such a combination of the supply and demand influences as now appears probable.

What of Confidence? Much has been made of the fact that confidence is necessary to business progress, and to a certain extent this is true. On the other hand, those who expect to see a revival of confidence before there is some measure of improvement are apt to be disappointed. The stage is set for the next act; another upward surge in our erratic recovery program seems to be starting; when the actors have learned the nature of the part they are to play, confidence will quickly return. That, in fact, is one of the principal dangers ahead, that confidence will become recklessness when the inflationary progression has continued a little longer. But there is time enough for the practical man to worry about that when it comes.