

# Inflation and business recovery

BY ARTHUR B. ADAMS

## Bank Note and Bank Credit Expansion

THE National Emergency Banking Act was passed for the chief purpose of permitting banks in sound financial condition to operate under conditions of a financial panic. Some people are under the impression that the operation of the Act will result in considerable inflation of bank credit and bank currency. As a consequence of the Act, undoubtedly, there will be some increase in bank currency, and it is probable that there will be some increase in bank credit, but the amount of inflation of bank credit which will result from the Act probably will be comparatively small. The chief result of the Act will be that which was intended; that is, to enable sound banking institutions to carry on their regular banking operations under conditions of a financial stringency.

The emergency "circulating" notes which the Federal Reserve banks are permitted to issue under the Act will enable the Federal Reserve bank to accommodate member banks in rediscounting their sound paper and in supplying them with adequate bank currency. The emergency notes are based upon the rediscounted bank paper or government bonds held by the Federal Reserve banks, and will be put into circulation only as sound member banks borrow from the Federal Reserve banks. Operation of the circulating note provision of the Act will bring some increase in the amount of Federal Reserve bank currency in circulation, but that increase will be temporary as the circulating notes are to be withdrawn from circulation when the financial emergency conditions have passed. The circulating notes will take the place of the government currency which is still hoarded; they will also take the place in circulation of the increased amount of other currency held by banks as reserves. They might be used to some extent as a substitute for checks on deposits. These emergency notes will not increase the amount of purchasing power owned by the public; but they will enable the public to use the purchasing power which it owns, but which otherwise might be tied up in banks.

The temporary liberalizing of the rediscount policy of the Federal Reserve banks provided for in the Act will enable member banks to rediscount at the Federal Reserve banks paper which heretofore was not acceptable for rediscount. This provision, therefore, will enable member banks to get accommodations at the Federal Reserve banks which they could not have secured before the passage of the Emergency Banking Act. Under the rediscount provision any member bank which is in sound condition and has sound assets will be able to borrow from the Federal Reserve banks in case that it needs to borrow.

These two provisions of the Act will enable all sound national banks and most of the sound state banks to secure sufficient loans and currency from the Federal Reserve banks to enable them to supply all the currency needs of their depositors and to make additional sound loans to their customers. Thus, the sound banks in the country, as a result of the Act, are put in the position to increase bank loans in most of the communities where there is a demand for additional credit for legitimate business purposes. The Act has brought about the re-establishment of public confidence in the soundness of our banks. The revival of confidence in our financial institutions has inspired some new confidence in the general business situation and may therefore result in greater borrowing at banks for business purposes.

To the extent to which the Emergency Banking Act inspires confidence in the present business situation, it will result in some increase in the use of bank credit for business purposes; this would bring about some increase in the physical volume of business, and may result in a rise of prices in some industries. I do not expect, however, a great expansion in bank credit as a consequence of this Act, and, certainly, I do not expect any appreciable rise in the general price level resulting from the expansion of bank credit brought about by the Act. The Act placed the business men of the country in a position where they would be able to secure additional bank loans to expand their business as they see the justification for such expansion. But, at the present time, in most businesses there are not sufficient prospects of profits to

be gained by increasing business activities to justify the business managers in borrowing large sums of money from banks for the purpose of expanding their business activities. In other words, in order to expand bank credit, which would be put into circulation as purchasing power, it is necessary to find solvent borrowers who desire bank loans in order to increase their business operations. Practically all sound banks in the different sections of the country now have adequate reserve loaning power to expand bank credit, but many of them are unable to find solvent borrowers who desire to use additional bank loans for profitable business ventures.

During a business boom it is easy to expand bank credit because there are plenty of borrowers who desire to use bank credit for new business purposes, but during a depression like this one there are few borrowers who desire additional loans for business expansion. Those individuals who advocate the expansion of bank credit in order to bring about business recovery apparently do not realize that business recovery is not dependent alone upon the availability of bank credit; business expansion is dependent primarily upon the prospects of profits from expansion, and bank credit is used only as a means of expanding business in order to gain the profits. In other words, bank credit expansion is a result of improvement in business rather than a cause of it.

If consumers now had plenty of buying power we would soon have an increase in the volume of sales, a rise in prices, expansion of bank credit, and business recovery in general. But the current income of consumers has been greatly reduced by the depression and unemployment, and they are unable to bring about revival by increased buying. Should several of the old industries enter upon a policy of expansion we would have an expansion of credit and business revival, but most of the old industries are already over-expanded. If we should develop profitable new industries business would improve and bank credit would expand. But where are the profitable new industries to develop? If foreign nations had the money and the desire to purchase goods from us in large quantities, bank credit would expand and business would improve. But neither business nor bank credit will expand unless there are prospects of profits to be gained from such expansion.

## Government Paper Money Expansion

The issuance of government paper money in the form of Treasury notes even in large quantities would not necessarily have the magical effect of bringing about even a temporary improvement in business conditions. For example, the issuance of a billion dollars

of Treasury notes in order to balance the Federal budget, or to pay for past government expenditures, would do little to stimulate business. Such an issue would increase the purchasing power of the consumers of the country only to the extent to which current taxes were thereby reduced and the tax savings used by the citizens to purchase goods and services. On the other hand, an issue of Treasury notes to pay large soldiers' bonuses or to pay cash doles to the unemployed would temporarily stimulate the purchasing power of the public, and would doubtlessly bring about some increase in the price level as well as in the physical volume of production. But, as soon as this artificial supply of purchasing power ceased (and it would surely cease) there would be a definite fall in the purchasing power of the public and a probable decline in the physical volume of retail sales; the probable result would be that the country would again suffer a business slump.

It might be argued, however, that what the country most needs at present is some artificial stimulus to start business going again, and that if business could secure such a stimulus to start the wheels of industry turning, our industrial system would continue to operate in high gear when this stimulus was removed. The soundness of this argument would depend wholly upon whether the artificial stimulus would result in bringing into play real industrial stimuli which would take the place of the artificial one when it was removed.

So far as I am able to see, there is little or nothing in the present business situation which would cause one to believe that government paper money inflation would bring into play real economic stimuli which would produce permanent business recovery. It is conceivable, theoretically, that an increase in the physical volume of production brought about by an artificial increase in the money income of the buying public would be carried over after the artificial purchasing power ceased to flow to consumers, but I doubt that such would be the actual result. Our foreign trade could be stimulated by paper currency inflation only if the paper money issued depreciated so that we were forced off the gold standard; then, our goods would become cheaper in the markets of the world in terms of gold and of foreign goods than they are today. We would thereby stimulate exports and discourage imports of goods by further lowering our price level in terms of gold. If prices in this country were raised by inflation and the paper money did not depreciate our exports would surely decline and our imports would increase. In the face of the present excess capacity of production in most industries in this country, a rise in our

price level brought about by inflation would not result in a great domestic industrial expansion movement. At present we have too many vacant buildings and too many idle factories to justify building others.

Again, part of the improvement in prices and in volume of production brought about by paper money inflation might be made permanent if *real wages were raised correspondingly as production increased* so that the consuming public would have a permanent increase in current purchasing power to correspond with the increase in production. But, as prices and volume of production have risen in the past, real wages per day have not been increased proportionately. In other words, inflation of values in the past has not increased the current purchasing power of the consumers in proportion to the increase in the value of goods produced and offered for sale. The money value of the wage payments to workers does not increase as rapidly as the money value of the goods produced when prices rise and production increases. Herein lies the fundamental reason why a rise in values due to inflation has always resulted in another business crisis. If wages and employment could be increased faster than prices and volume of production the upswing in business might be permanent.

On the other hand, a big issue of Treasury notes would enormously increase the public debt, and if the policy of issuing them was continued for a considerable period of time the country would be forced off the gold standard and on to a depreciated paper currency basis. This situation would bring additional decline in the purchasing power of wages and more uncertainty to business.

A bond issue by the Federal government to pay for a public improvement project would increase the indebtedness of the government just as would the issuance of Treasury notes equal in amount to the bond issue. To the extent to which the bonds were purchased out of the savings of the public private expenditures would be curtailed to about the same extent that public expenditures were increased. To the extent to which the bonds were purchased on credit by the public, bank credit would be expanded and total public and private expenditures would be increased to the extent of the amount of the expansion of bank credit. In this case, there would be little difference in the results between, first, the Federal government issuing Treasury notes to pay for a public improvement project and, second, the government selling bonds to pay for such a project—in both cases the indebtedness of the government would be increased to the same extent and the temporary

purchasing power in the market would be increased. The issuance of short-term Treasury certificates to pay for public projects would have almost the identical effect as issuing Treasury notes for circulation to pay for the projects. The resulting increase in bank credit from the short-term Treasury certificates would be about the same as the amount of the certificates issued.

### Inflation Through Bimetallism

There are those who believe that the general price level should be raised by lowering the intrinsic value of the gold dollar either by the adoption of bimetallism or by a limited coinage of silver or by reducing the amount of gold in the dollar. The adoption of bimetallism at the present market ratio of gold and silver (which would be somewhere around 42 to 1) would actually lower the intrinsic value of gold per grain because it would lessen the use of gold for currency purposes and would thereby lower the intrinsic value of the gold dollar; the level of prices would consequently rise to some extent.

But, if gold should be undervalued and silver overvalued in the ratio fixed by law (say at a ratio of 30 to 1) gold would not be coined, and the silver dollar would be worth less than (only about 75 per cent of) the present gold dollar; prices would thereby be raised but we would be actually on a silver basis rather than on a gold or a bimetallic basis. Practically all students of monetary problems are opposed to going off the gold standard and adopting a silver or some other standard. In spite of its fluctuations in value, gold is the most constant standard of value that the world has yet discovered. Any other standard brings more uncertainty as to the stability of the value of the dollar. Certainly, if we should go on a silver standard the production of silver would be enormously increased and the value of the dollar would be correspondingly decreased. Prices would thereby be raised as a result of the constant decline in the value of silver; the enormous uncertainty as to the future value of the silver dollar would interfere with the continuity and stability of the country's business.

### Limited Coinage of Silver

In this country, we also have those who advocate that we remain technically on the gold basis, but that the government each year coin a limited amount of silver by purchasing the bullion in the market in order to increase the total volume of money in circulation. Such a policy, in reality, would be another variety of currency inflation; that is, it would be a method of increasing the money in circulation by a constant increase in government credit; the process

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would not be so very different from the issuance of Treasury notes in order to increase the volume of money in circulation. If the government should purchase one billion dollars worth of silver from which it coined three billion of silver dollars, two billion of the three billion dollars would be government credit, and one billion of the three would be the intrinsic value of the silver in the three billion silver dollars. In other words, two-thirds of the face value of these dollars would be government credit. The only advantage (if it is an advantage) which I am able to see in such a coinage of silver over the direct currency inflation method would be that the price of silver would thereby be increased; this would be little or no benefit to the public, but it would be of tremendous help to the silver producers.

If the nation is intent upon increasing the volume of credit money, why not do it directly by issuing paper money rather than through the subterfuge of a limited coinage of silver? The results of the inflation of government credit money would be the same in the case of limited coinage of silver as issuing Treasury notes. The historical argument that the Far East (particularly India) uses silver, as the standard of value, is no argument for a limited coinage of silver by the Western nations. It is more of an argument for free coinage of silver, or for a silver standard, which would give the same common denominator to all countries for the comparison of values.

### Inflation by Decreasing Size of the Dollar

The remaining inflationary measure proposed is to decrease the number of grains of gold in the gold dollar in order to decrease the intrinsic value of the dollar and thus increase prices. At the present time, the gold dollar has 23.22 grains of fine gold in it. Should the standard of the dollar be reduced to 18 grains of fine gold, it would thereby be reduced in size approximately 22 per cent, and there would result an increase of about 27 per cent in the number of gold dollars coined from the amount of gold which is now used for monetary purposes in the United States. Such a change in the coinage act would give the Federal government a profit of several hundred millions of dollars—which profit may be called a “money debasement profit.”

Such a coinage change would automatically scale down all private debts that are not made payable in gold dollars of the present weight of 23.22 grains. Such a change would also give immediate paper profits to all business enterprises by increasing the “dollar value” of stocks of goods and capital equipment which they

possess. It might also tend to curb temporarily the flood of cheap foreign goods coming into the American markets because of the depreciation of foreign currencies—it would raise the dollar value of these currencies.

On the other hand, the reduction of the amount of gold in the dollar would adversely affect the purchasing power of wages, and certainly it would not immediately increase the general purchasing power of the consuming public. Such a reduction in the value of the dollar would save some businesses from failure that would otherwise fail because it would result in the automatic scaling down of business debts not payable in gold dollars of present weight. But the policy would produce a considerable amount of uncertainty as to the stability and soundness of the American dollar, because if such action should be taken once by Congress, it might be taken again.

Should the American people decide that the non-inflationary policy of business reconstruction is entirely too drastic and that some inflation must be had, I believe, that of all the inflation methods, it would be least harmful for us to bring about a rise in prices and values by reducing the amount of gold in the dollar. This method would be more certain than the attempt to increase prices by bank credit inflation. The adoption of such a policy would stop the present propaganda of the silver producers to raise the price of their product through legislation. It would not increase government credit or debts. Also, this method of raising prices would give some relief to debtors by reducing the present value of their debts, but it would affect the currency purchasing power of laborers adversely because it would not raise wages with prices.

This method of raising prices has a historical background; it is exactly what France and Italy did through the currency inflation route during and after the war period. England is now on a paper basis and should she return to the gold standard, she probably will not be able to push the pound sterling up to \$4.8665 (with 23.22 grains per dollar). She will unquestionably stabilize the pound at a much lower gold value level. I do not advocate that the United States adopt this or any other method of dollar inflation. I only point out that should public opinion force some inflationary legislation, this type would be the least harmful.

### Recovery on Non-Inflationary Basis

I believe that the soundest policy of readjusting business in the present depression is to readjust it largely on a non-inflationary price and value level. By readjusting on a non-inflationary basis, all of the war and post-war inflation of values will be squeezed out of our business fabric, and we should be able to

operate in the future on a sound basis. In the face of the recent decrease in our foreign trade and the overdevelopment of industries which we now have, it is evident that the future operations of American business will be forced to depend very largely upon the actual current money income of the American people—this income must be derived wholly from the production of goods and services. Should we attempt to revive business by creating an artificial income for that purpose, we would likely produce a false start toward recovery; because as soon as the inflation stimulus was removed we would then have to readjust business upon the sound basis of the actual current money income of the people. This being true, we might as well readjust at the present time on the bed rock basis of reality.

In readjusting business to a lower value level the chief problem with which we have been wrestling for the past three years is that of scaling down capital and other fixed charges. The break in the stock market scaled down the market value of shares of stock; the break in commodity prices temporarily destroyed the earning power of most of those shares; but the business enterprises themselves are still confronted with the problem of scaling down the fixed capital charges which they had at the beginning of the depression. In other words, the big problem confronting us at present is the liquidation or adjustment of the funded and unfunded debts of business enterprises. Many of our business enterprises are not in a position to pay interest on their funded or bonded debts (to say nothing of the principal) and the prospects are that several of them will never be able to pay the contract interest on the face value of their bonds. The unsecured open accounts of other enterprises have not been paid and in many cases will not be paid. The short-time bank loans of others are still “frozen loans” and may never be paid in full. Many of our real estate mortgages can never be paid in full by the individuals who secured the loans, unless the whole agricultural price and value level is raised.

Therefore, the readjustment of business on the lower value level means the scaling down of business debts either by voluntary agreement or through foreclosures and receiverships. Whether it is by voluntary agreement or by receivership the practical results will be the same; many business enterprises will not be able to earn sufficient current net income to pay the agreed rate of interest on the outstanding debts. In other words, if business is readjusted on the lower price level practically all creditors and money lenders, whether manufacturers, merchants, bankers, insurance companies, or the government, will be compelled to accept the scaling down of

the principal of debts to be paid, as well as the amount of interest to be received on them. Only by such debt adjustment and liquidation could the heavily involved business enterprises operate at a profit on a lower price and value level.

The adjustment to a lower level of values also means that direct operating expenses must be reduced far below the 1929 level. High salaries and high overhead expenses must be trimmed. In most cases this has already been done. The trimming of overhead and operating costs will bring about maximum efficiency in the operation of business enterprises. A high degree of efficiency is necessary in order to get even a small return of profits under such conditions.

The only inflationary movement which should be permitted to occur in this country at the present time is a slow increase in bank credit as it is demanded for self-liquidating business purposes. When fundamental conditions become favorable for business to improve business managers will seek loans at banks for the purpose of expanding their businesses. Business expansion should not be forced by artificial and temporary inflation of our currency or money. It is probable that we shall have some expansion of bank credit and a slight rise in the general price level in the near future as a result of the normal recovery from the depression. As a result of the gradual improvement in business for the next year or so, it may again become advisable to take public measures against the over-expansion of bank credit because of new dangers of credit inflation. Just now there is little or no danger of the over-expansion of bank credit.

It is easier to make the patient sick than it is to make him well. Certainly, opiates do not cure a disease, they only temporarily ease the pain caused by the disease and leave the patient in a weakened condition. Our economic system is sick and needs a surgical operation to remove the malignant growth of excess debts, and a course of treatment which will bring about a more even circulation of wealth or the distribution of money income. Administering inflation will only aggravate these diseases. Only by readjustment on a non-inflationary basis will we be able actually to cure the disease.

We have already made much progress in removing the excess debts by partial payment and by scaling them down. Excess stocks of goods are greatly depleted in many industries, and the volume of production is now slowly increasing in industry as a whole. Most employers have already been convinced of the soundness of the doctrine of high wages and reasonable profits. We shall doubtless readjust on a higher real wage basis than we had in 1929. Confidence in the business situation is slowly re-

turning. The revival of business has been slow and may continue at a very slow pace for a long period of time. We have the consolation of knowing that our movement toward business recovery has been made largely on a sound basis thus far.

(Since the foregoing was written, President Roosevelt announced that the United States had gone off the "gold standard." Dean Adams was asked by the *Oklahoma City Times* to explain the significance of the movement. This follows, taken from the newspaper:)

In placing an embargo on the exportation of gold the president announced that it was his intention to return to the gold standard on an adjusted gold value and gold reserve basis. I conclude from this statement that he expects to reduce the gold content of the dollar and that the decision of how much he will reduce it will be made sometime in the future.

The statement from the White House infers that the principal reason for taking this action was to strengthen the position of the nation in negotiating with the statesmen of other nations in reference to the forthcoming international economic conference at London.

The inference is that we shall be in a better position to negotiate with other nations if we place ourselves in the same boat they are in reference to inflation.

It is also stated that by deflating the value of the American dollar, the United States will be in better position to negotiate in reference to the foreign debts.

Another reason given for taking the action is that by bringing about inflation in the United States we shall be able to stop the flood of cheap foreign goods in the American market which was brought about by the inflation of European currencies.

I question whether or not the United States will be in better position to negotiate with the foreign countries because of the president's inflationary measure. I grant that the deflation of the American dollar in the foreign markets, will tend to reduce imports into the United States, and will to some extent stimulate exports, but, I believe, that the results of our inflation upon our foreign trade will be much smaller than is anticipated by the White House—neither do I believe that we shall be able to collect any greater amount of the foreign debts as a result of going off the gold standard.

There are two reasons why we shall not be able to collect a great amount of the foreign debts. First, the European nations have decided not to pay, and, second, they have a very limited means of paying.

But, the inflationary action of Mr Roosevelt will have a tremendous effect upon the domestic trend of business. The extent of the rise in the domestic price level will depend upon the degree of inflation which Mr Roosevelt finally decides to bring about. If he decides to reduce the gold content of the dollar 50 per cent, there will be a considerable increase in the general price level. On the other hand, if he decides to reduce the gold content of the dollar only 10 per cent, there will be only a slight increase in the general price level.

Business will remain somewhat uncertain until he announces his definite policy, though there is a general impression that the amount of inflation which he intends to bring about will be considerable, and that belief for the time being will cause a definite rise in the general price level. There will be an increase in the value of all tangible goods. Including farms, city buildings, etc., the decrease in the value of the dollar will cause those who have cash money in the banks to convert it into

tangible property or goods in order to protect themselves. The prospect of a rise in retail prices will cause consumers who have surplus money, or reserve credit, to buy now for future needs. There will be a tendency for retail merchants to replenish their stocks and for manufacturers to buy surplus quantities of raw materials. There will result an increase in the volume of sales in the wholesale and retail markets. Some immediate increase in the volume of production and decrease in unemployment will result.

The debtor class will receive some relief as a result of the rise in the value of the products they produce. However, unless business receives a new shot of inflation later on, I expect the effect of the present inflationary action to wear out. Wages will not rise as rapidly as prices.

The increase in employment will not be as great as the increase in the physical volume of production. The increase in the money income of wage earners and salary receivers will not be as great as the increase in the value of the consumers goods they will be expected to purchase.

As a result of the increase in prices there will result a decrease in the actual purchasing power of the American consumer. Consequently, there will be eventually a decrease in the volume of retail sales, then a decrease in the volume of wholesale sales, and a reduction in the volume of production.

Prices will again fall and we shall return to the impasse in business that now confronts us. If Mr Roosevelt is to follow the hazardous path on inflation, he must force an increase in salaries and in wages in order to keep business operating under the conditions of higher prices, or else he will be forced to the alternative of continuing to inflate prices to keep business operating temporarily. This alternative would prove disastrous in the United States as it did in Germany.

Dean Adams, in a talk before the We-woka chamber of commerce, expressed his opinion that money inflation will never cure the basic economic ills of the country unless wages are increased correspondingly.

"President Roosevelt must use the sovereign power of the federal government to inflate wages in similar proportion to the inflated value of goods if industry is to continue in the hands of private control.

"The deficiency of consumers' purchasing power is the 'king pin' of our national economic jam. If the president has a right to change some of our economic relationships by influencing the price level through inflationary policies, he has an equal moral right and duty to change other economic relationships by influencing the wage level through executive control.

"It is high time that in the interests of the public, the federal government assume some definite direction and control of the primary economic relationship of our people, rather than following the old policy of leaving them to economic determinism and to big business.

"The operation of the natural economic laws together with the governmental policies dominated by the big business interests have put us where we are today."