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GREAT BARRINGTON MASSACHUSETTS

# RESEARCH REPORTS

## COMING EFFECTS OF CURRENT EVENTS

### *Return to Gold?*

The efforts of the Economists' National Committee on Monetary Policy for several years, the recent activities of the Gold Standard League, and widespread discussion of possible devaluation of the dollar have aroused much interest in the possibility of return to a complete gold standard similar to the one that the United States had for a century prior to 1933. The views of the Nation's principal monetary authorities, those directing the activities of the Federal Reserve System, have been revealed within the past few days.[1]

Elsewhere in Institute publications[2] we have discussed certain aspects of this problem at greater length than the space here available permits. These discussions adequately expose the fallacies in the arguments offered by Mr. Sproul and Mr. McCabe against return to a gold standard with currency and demand deposits convertible to gold on demand. However, their principal contentions deserve consideration here. Mr. Sproul asserted, "When you boil it all down * * * the principal argument for restoring the circulation of gold coin in this country seems to be distrust of the money managers and of the fiscal policies of Government." Although he agrees that some checks on money management are desirable, that "discipline is necessary in these matters," he urges that the control over the commercial bankers operating the money-credit system should be discipline by "competent and responsible men," meaning the heads of the Federal Reserve System. In short, he argues that the Federal Reserve authorities should be unrestrained in their operations by the automatic restrictions of the complete gold standard, that the public should have no right to obtain tangible value on demand in order to test the operations of the money managers.[3]

As an instance (the only one mentioned) of the irresponsibility of the public in this respect, Mr. Sproul cites the public's demand for gold coin in early 1933. However, he neglects to mention the fact that Mr. Roosevelt's intention to abandon gold and do something for silver was revealed to his intimates (and therefore of course to their intimates, etc.) in January 1933. Naturally, as increasing numbers of individuals learned from sources they considered authoritative that the Government was about to embark on monetary experiments, these fortunate individuals sought to convert their currency and demand deposits to gold. Mr. Sproul speaks of this incident as "embarrassing," and especially revealing is the fact that the money managers apparently attribute their embarrassment to the general public and not to irresponsible government, where the responsibility for what happened obviously belonged.

We believe that Federal Reserve authorities are advocating a policy that is unsound in fundamental principle and that has already worked badly in practice when they urge that the Nation's money should be managed even by "competent and responsible" men without the restraint and continuous possibility of check imposed by the complete gold standard. However, before explaining our reasons for this conclusion, brief discussion of one aspect of the gold standard is desirable.

#### *Elasticity of the Gold Standard*

Contrary to what apparently is a widespread misunderstanding, the gold standard does not provide a strait-jacket within the confines of which adjustment to changing circumstances is impossible. Although Mr. Sproul speaks of the "automatic discipline of a harsh and preverse mechanism," the fact is that the gold standard, especially in the period since inauguration of the Federal Reserve System, provided highly elastic credit facilities and was nearly as different from a strait-jacket as any

[1]These views have been made public by Mr. Allen Sproul, president of the Federal Reserve Bank of New York in a speech before the Annual Convention of the American Bankers Association in San Francisco, California, November 2, 1949, and by Chairman Thomas B. McCabe of the Federal Reserve Board in his reply to a list of questions submitted by a congressional subcommittee.

[2]Chapter IX, "Gold: Its Function and Significance," *Cause and Control of the Business Cycle*, and chapter II, "That Gold Has Not Been A Good Servant," *Current Economic Delusions and Their Probable Future Effects.*

[3]A modern money-credit system, which extensively uses credit in the form of paper currency and checking accounts, can continue to operate successfully in the long run only if the public has confidence in the credit instruments used. The only practical test of confidence in such instruments is to offer the corresponding tangible value freely on demand and see what the public does. If the demand for convertibility is negligible, the public obviously is confident that the value of the credit instruments will be maintained. Conversely, if the public demands redemption in gold, when that is the money standard, the public obviously lacks confidence in the credit instruments. The complete gold standard with redemption in gold coin or bullion on demand has the dual advantage of providing the money-managers a continuing and up-to-the-minute test of the public's confidence in their policies, and it also gives the public a means of controlling the policies of the money managers, of informing them without the delays incidental to the passage of new legislation that the course of action being followed is not such as to maintain confidence.

control providing effective ultimate control probably could have been. So much elasticity was provided by the Federal Reserve Act, so much room for the exercise of discretion by the money managers, that Elihu Root greatly feared there was too much room, that errors of judgment might become too great before they were checked.[4]

Since 1914, when the Federal Reserve System was established, the money managers have had a wide range within which their discretionary powers could be and were exercised. Restoration of the complete gold standard would not alter that situation.[5] The money managers would still have broad scope for the exercise of their powers to expand and contract credit in accordance with the needs of business.

In view of the foregoing, precisely what degree of freedom from restraint do our money managers seek? In order to expose the significance of their aims, a brief explanation of the purpose that money serves is necessary.

### *The Importance of Value Changes*

Monetary experts have long agreed that money, in the words used by Mr. Sproul, "is a standard of value and a medium of exchange." For the purposes of this discussion, only these two functions of money need be considered.

As is evident from mere observation of present developments throughout the world, a nation's money or currency can serve more or less satisfactorily as a medium of exchange in spite of some fluctuations in value. In general, day-to-day transactions are hampered less by long-term fluctuations in the value of money than are transactions extending over prolonged periods. Nevertheless, extreme variations in value can cause complete abandonment of a nation's currency simply because individuals will not accept it but resort to barter transactions instead.

However, except in extreme instances, the public rarely has occasion to be concerned about the functioning of money as a medium of exchange. The primary and necessarily continuing concern of the public is with changes in the value of money, in what dollars will buy in the future.

Most men devote most of their working lives to the task of providing for their dependents. One measure of this devotion to the welfare of those dependent on them is provided by the more than $200,000,000,000 worth of life insurance now in force on the lives of American citizens. Savings invested in savings banks and Government bonds, which total nearly $150,000,000,000, are additional evidence of the great concern that citizens of the United States have for future obligations of one kind or another. Obviously, the value of money, present and future, is a matter of vital concern to every man who saves or who has life insurance or who hopes for a pension, and the value of money is equally important to every dependent of all such men.

### *Unscientific Procedures*

The freedom from restraint that our money managers seek would permit them to manipulate the value of the dollar without any close limitation on the magnitude of the changes. They are seeking to avoid the only *practical test* of their theories regarding the effects of their actions on the future value of money. We consider such an effort on their part demonstrably unsound procedure.

Now our money managers have the obvious duty of developing sound theory. Admittedly, neither economic theory in general nor monetary theory in particular is as yet scientific in the sense that word is here used. Wide disagreement among the experts is sufficient proof of the fact that the science of economics and of that portion of the field that might be labeled "money" is immature, to say the least.[6]

A cardinal principle of the scientific method is that theories and their logical implications should not be accepted merely on the grounds of general plausibility. Continual resort to tests involving practical application and observation of facts is essential for the development of sound theory. In fact, developing theory can be properly oriented and repeatedly reoriented as necessary *only by means of such tests.*

In seeking freedom from the restraints imposed by practical tests of their theories, our money managers are being unscientific. They have chosen a mode of behavior that would have been universally approved in the time of Aristotle, but man has learned too much about knowing and the known since then to be satisfied with such a primitive approach to problems of great importance. Not mere "competent and responsible men" but omniscient gods would be needed to manage a money-credit system in the manner Mr. McCabe and Mr. Sproul have urged.

### *Practical Considerations*

So much for what may be considered our theoretical objections. Have we any tests that will aid us in judging how "competent" and "responsible" our money managers actually are, tests that some readers may feel provide a practical rather than merely a theoretical answer to the money managers' request?

The Federal Reserve System has been in operation for nearly four decades. With the help of hindsight, one can see that a series of major blunders have been made. (They are discussed in detail in the publications already referred to.) Now this fact does not prove that our money managers are less competent than other men

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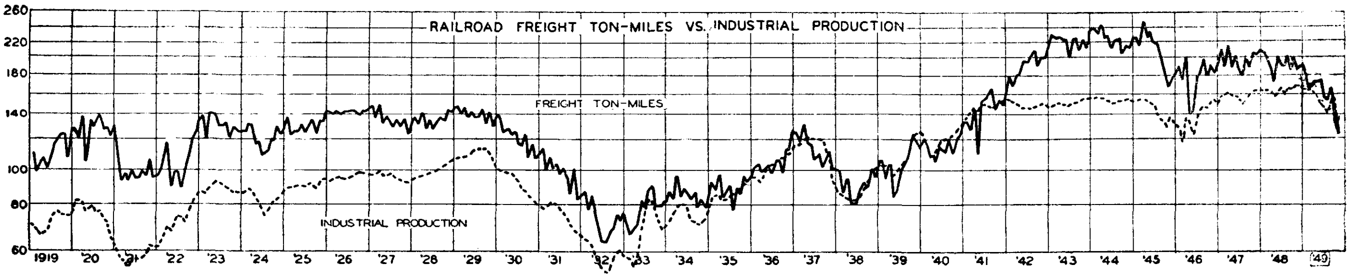
[4]His prophetic warnings when the Federal Reserve Act was under consideration in 1913 are quoted at length in the Institute publications previously referred to. After pointing out the grave danger of serious inflation, the tendency of bankers as well as others to become overoptimistic under such circumstances, and the inevitable disaster that must (and, as we all know, in 1929 did) follow, he said: "So we are all moving in the same direction, in a direction which, unless brakes are put on somewhere, is going to land us in inflation. I conceive it to be our duty to put the brakes on, and not leave it for anybody else to do it, or not to do it, as he sees fit."

[5]The present gold holdings of the Federal Reserve System *in excess of* legal requirements approximate $12,600,000,000. This could serve as the reserve for a further expansion of demand deposits (checking accounts) totaling some $250,000,000,000, several times the amount now in use. Alternatively, these excess gold reserves could be paid to holders of currency or checking accounts on demand. In view of the automatic decrease in required gold reserves when demand deposits or currency are converted to gold, more than $13,000,000,000 in gold could be paid to hoarders on demand before any contraction of bank credit with resulting deflation would necessarily follow.

[6]Men have been struggling for uncounted centuries to acquire knowledge. At last we are beginning to understand what knowledge is and how it may be acquired. John Dewey has clearly described what may be called the evolution of human behavior in this field, and there is now general understanding that the scientific method provides the only "warranted assertibility" or knowledge to which we are justified in giving much weight.




or are relatively incompetent, but it does prove that they are *not absolutely* competent. In other words, they are human, fallible, and subject to the influence of politicians who can hire and fire them.

As far as their being responsible is concerned, what is one of the chief characteristics of a responsible man? Is it not a willingness, even an eagerness, to meet all his obligations as stated in the letter of the bond? Yet it is precisely in this respect that our money managers desire to differ from responsible men. They wish to define "dollar" as one thirty-fifth of an ounce of gold, unequivocably and unchangeably (and with that aim we concur); then they desire to issue obligations payable in "dollars" on demand but reserve the right to refuse payment on demand; in fact, they even insist that payment in "dollars" (as defined) must never be demanded, because they are "competent and responsible" men. If this is not the essence of high handed irresponsibility, then the words that ordinary people are using need redefining.

*Conclusion*

*We consider that return to the complete gold standard (including convertibility of all United States money to gold coin or gold bullion on demand) is the essential first step to further progress in the development of sound monetary practice and theory. Continuation of our present monetary arrangements, which include an irredeemable paper currency, is more than a step backward; it is a detour to a route that has led to ultimate disaster for every nation that has followed this course since the dawn of recorded history.*

## SUPPLY

### *Industrial Production*

Steel-ingot production, scheduled at 54 percent of capacity for the week ended November 19, 1949, was 154 percent more than production in the preceding week but was 44 percent less than that in the corresponding week last year. By November 15, operations in most of the Nation's steel mills had been resumed. Only minor damage to furnaces because of the shut-downs has been reported. Therefore, only a brief delay may occur before prestrike rates of operations are resumed.

| | *1929* | *1932* | *1937* | *1938* | *1948* | *1949* |
|---|---|---|---|---|---|---|
| Percent of Capacity† | 73 | 18 | 35 | 63 | 99 | 54p |
| Weekly Cap. (Million Tons) | 1.38 | 1.52 | 1.51 | 1.54 | 1.80 | 1.84 |
| Production (Million Tons) | 1.01 | .27 | .52 | .97 | 1.78 | .99 |

Automobile and truck production during the week ended November 12, 1949, in the United States and Canada was estimated at 117,438 vehicles, compared with a revised total of 116,699 vehicles the previous week.

| | *1929* | *1932* | *1937* | *1938* | *1948* | *1949* |
|---|---|---|---|---|---|---|
| Vehicles (000 omitted)† | 49* | 11* | 83* | 86* | 116* | 117*p |

Electric-power production during the week ended November 12, 1949, decreased to 5,434,555,000 kilowatt-hours from 5,434,924,000 kilowatt-hours in the previous week.

| | *1929* | *1932* | *1937* | *1938* | *1948* | *1949* |
|---|---|---|---|---|---|---|
| Billion Kilowatt-Hours† | 1.79* | 1.52* | 2.18* | 2.21* | 5.57* | 5.43* |

Lumber production in the week ended November 5, 1949, decreased less than seasonally. *The New York Times* seasonally adjusted index was 3.9 points above the index for the previous week and was 0.7 points above that for the corresponding week last year.

| | *1929* | *1932* | *1937* | *1938* | *1948* | *1949* |
|---|---|---|---|---|---|---|
| *The New York Times* Index† | 127 | 36 | 72 | 97 | 101 | 101 |

**†Latest weekly data; corresponding weeks of earlier years**
p=preliminary; *holiday

## DEMAND

### *Department-Store Sales*

Department-store sales for the week ended November 12, 1949, were slightly more than sales for the previous week but were 9 percent less than sales in the corresponding week last year.

## PRICES

### *Commodities at Wholesale*

| | *1948* | *1949* | |
|---|---|---|---|
| (August 1939=100) | *Nov. 17* | *Nov. 10* | *Nov. 17* |
| Spot-Market Prices (28 basic raw materials) | 307 | 249 | 249 |
| Commodity Futures Prices (Dow-Jones Daily Index) | 309 | 285 | 284 |

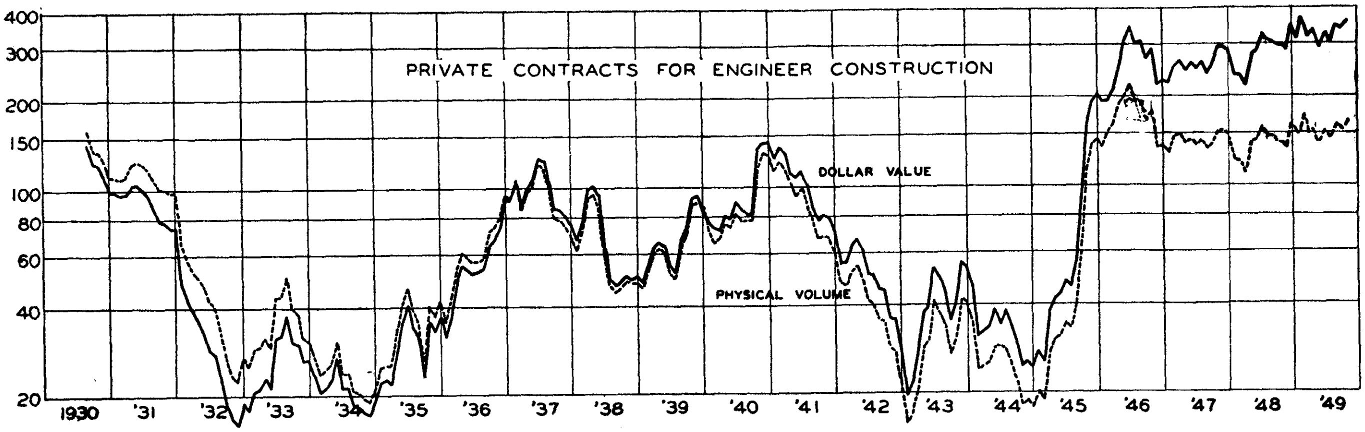
## BUSINESS

### *Freight-Ton Miles vs. Production*

Since May the trend of the index of railroad freight ton-miles has been downward. An increase occurred during August, but the curtailment of production resulting from the coal and steel strikes was quickly reflected in a rapid decline in the shipment of goods by rail during September and October. Freight traffic during October was at the lowest level since April of 1941, when a major coal strike seriously disrupted rail movements.

The narrowing gap between the ton-miles series and the index of industrial production was closed when the index of the former fell below that of the latter during September. However, preliminary economic data during a strike period frequently are distorted. Until post-strike data are available, the relationship between the two indexes will not be especially significant.

Authorization in August of a 4-percent freight-rate rise by the Interstate Commerce Commission again focused attention on the performance of competing types of carriers. Motor carriers, for example, have not increased their rates as much as railroad freight rates have increased. In view of the fact that truckloadings in September were 8 percent more than those during Sep-




tember 1948, whereas railroad carloadings were 23 percent less, a question arises as to the desirability of the increase in railroad freight rates.

*Recent traffic trends indicate that the railroads are no longer gaining freight more rapidly than industrial production increases, a condition that had prevailed for the first half of the present decade. However, if losses of business to competitors can be limited to the least profitable classes of shipments and if gross business can be maintained nearly in parallel with industrial production, the railroads should be able to operate profitably.*

## Construction Activity

Since last February, construction activity in general has increased markedly and by September was at record levels. By the end of the year total construction expenditures may exceed $19,000,000,000, 8 percent more than last year's all-time high and nearly twice the highs reached in 1926 and 1927.

Total nonresidential construction (including industrial, commercial, farm, and public-utility construction) undertaken by private interests has decreased since July and in October was 8 percent less than that reported for October last year. On the other hand, most construction undertaken by Government authorities, local, county, State, and national, has increased substantially since the early part of the year.

Private contract awards for engineer construction include large projects such as apartment housing and industrial construction undertaken and financed by private interests. The solid line on the accompanying chart is a 3-month moving average of the value of contract awards. The dotted line is a 3-month moving average of the physical volume of engineer construction. The latest figure shown is the average for the 3 months including October.

Apparently the business recession last spring had an important influence on the construction of large projects privately undertaken. By the end of July, contract awards were nearly 17 percent less than those reported in February, when an all-time high was reached. However, during the 3 months ended in October a 14-percent increase occurred, and the October figure was only 5 percent below the February high.

The trend of residential construction this year has paralleled that of construction activity in general. This type of construction increased 106 percent during the 7 months ended September to an all-time high. The physical volume of residential construction increased similarly, but the September high was still below the highs of the mid-1920's.

Approximately 100,000 units of new housing were started in September and again in October. The accumulated total for the first 10 months of this year was nearly 850,000 units, 100,000 more than the total for the corresponding period last year.

*Seasonal factors probably will force some curtailment of construction activity during the next 3 or 4 months. However, construction activity probably will be maintained at high levels for several months at least. The veterans' insurance dividend will encourage demand for housing to some extent, and many individuals who postponed purchases in the hope that prices would be lower apparently are willing to buy the somewhat better value now available. On the other hand, gains in total construction activity probably will be limited as a result of smaller demand for industrial and commercial buildings.*