The Role of Bank Credits

It is of significance, then, that with this has come, also, a release of bank credits on a scale never before witnessed. They have put into circulation the needed additions to purchasing power without which the increase in consumer income and living standards would have been impossible. This increase has come out of new consumer credits extended by the banking system for instalment sales, and out of producer credits in the form of wage advances and profits for the upbuilding of new industries, in large measure before their products, converted into consumer goods, could come into the market.

In providing supplies for this new construction, the idle plant of 1921 has been requisitioned along with the rest, into producing for the augmented sales of production and consumption goods of 1926 and 1927.

This has occurred in a degree fortuitously and without concerted action. A brief analysis may help point the way to a definite planning effort that might be expected to lead to yet greater and more gratifying gains.

Dr. Benjamin N. Anderson, Jr., economist of the Chase National Bank of New York, has shown[12] that the expansion of bank credits between June, 1922, and June, 1926, of $9,600,000,000 exceeded by more than $2,500,000,000 the expansion of credits during the war. The combined bank loans and investments, which stood at $31,700,000 in 1919, had leaped to $42,700,000 by June, 1926. Out of this expansion proceeded a great and parallel expansion of bank deposits. In 1922, when the Federal Reserve banks were buying acceptances and government securities in the open market, the member banks alone reported an increase of $2,000,000,000 in deposits. In 1926, this experience was repeated, the member bank expansion exceeding $2,500,000,000 in deposits and $2,000,000,000 in loans and investments. Meanwhile gold imports, from the beginning of 1922, increased the reserves by nearly $900,000,000 to a total of $4,500,000,000 by November, 1924.

This flood of new credits overflowed the real estate markets and the securities markets, and became effective in increased commercial credits for building construction, instalment buying, and exports.

Dr. Henry E. Chandler, economist of the National Bank of Commerce in New York, tells how[13] during the three years from March 31, 1924, to March 23, 1927, the reserve balances of member banks increased by $428,000,000, and these reserves were expanded by twelve times in loans and investments, amounting to $5,000,000,000. During this period the total loans and investments of all banks in the United States increased by more than $8,000,000,000. Monetary gold increased by $230,000,000 in the same time, with an attendant primary and secondary expansion of loans amounting to more than twenty times this amount, and of loans and investments to thirty-five times.

It was by this unprecedented expansion of credits permitted by the elastic provisions of the Federal Reserve act, and helped by the rediscount and open-market policy of the Federal Reserve Board, that the country has had "easy money" during the past five years. By such means there have been billions of credits with which to inflate the stock market; billions to lend to Europe; more billions for real estate, and then some extra billions for new industrial growth, particularly in the automobile, building and electrical industries.

These extra billions of absolutely new money have been advanced in wages and in the price of supplies from all industry in the process of new construction of capital facilities. They have potently aided in making up the shortage of consumer buying power occasioned by the savings of corporations and individuals, as expressed largely in the form so familiar to the members of the Taylor Society—that of unused plant facilities—and, to a degree, have put these facilities to work.

The process is analyzed at length in the books of Messrs. Foster and Catchings[14] which present their theory of the deficits of consumer purchasing power and how these deficits may be made up by the right flow of bank credits into capital construction.

But these authors point out that the expansion of credits that has taken place during the past few years has been beneficially graduated only by happy chance. It has simply happened that the automobile industry could absorb much of this added flow of bank money by reason of its potentialities of growth. In this process the new industry took the major part of the surplus labor and products of the older industries. Thus the added flow of bank credits, representing a new creation of money in circulation, gave labor an added flow of wages in a new field; provided consumers with a direct source of new money in instalment credits, and supplied industry as a whole with added markets for its overspill.

Yet despite this great volume of business in the building of a new industry and the expansion of others, the wholesale price level has sagged, gently but continuously, during the past three years. That means that goods have still poured into the market somewhat faster than consumers could take them away on a stable price level. Their buying power, fed by the credit expansion of the new motor industry, rose providentially to prevent the sag in prices from becoming steeper in precipitous declines, and in time to enable manufacturers, especially those geared to large-scale production, to apply the increased economies of scientific management that have reduced costs and wrung profits out of the rather lower price level.

The principle of this beneficent credit process, permitting a gain without parallel in the standard of living of any nation, is thus formulated by Messrs. Foster and Catchings: *"It is impossible for the United States, or for any country, to use the facilities it already has, to a sufficient extent to keep business prosperous, unless it continues to expand bank credit at a sufficient rate in connection with the building of new facilities."*

Of course, if the facilities for producing goods with existing equipment can be utilized more scientifically, whether by management methods or by installations of improved machinery, or both, they will dispense with man-hours and consequently with wage earners at an increasing rate. By so much the more, then, it becomes necessary to provide these surplus wage earners with employment in new industries, thus recouping purchasing power through wage payments for the erection of the capital plant of these industries.

It should be borne in mind, also, that while lowered production costs may result anyway in a somewhat lowered price level, and resultant gain in real wages, this gain can be realized only by those who continue in employment. In any event there can be no resultant gain for workers who are dispensed with, hence no gain in consumer purchasing power, if they are left without alternative employment and are cut off from the sources of renewed purchasing power in wages. Eventually the dearth of purchasing demand, springing from the want of growing numbers of the disemployed, would find its sure reflection in an increase of unused facilities undergoing the charges of depreciation.

Outlets Into "Non-Productive" Public Works

Foster and Catchings have observed, further, that during the process of constructing new capital facilities, toward which the displaced worker may find his way and industry its outlet for the sale of surplus goods, it makes little difference whether the borrowed money is used to build a factory or a city hall.

Once these new facilities are built, however, it does make a great deal of difference if there remains in the industry to which the putative factory is added, a margin of unused facilities. For the result must be, without some new outlet for the surplus goods in that industry, that the addition to its unused facilities of a new factory is so much excess equipment.

In such case it were better if the new capital construction had gone into a city hall or other public works, which, when completed, could not be used for the further production of intermediate or consumer goods. It may be said, therefore, especially during the present rebirth of existing facilities through more productive management and improved tool-power, that the planners of prosperity may look to the building of "non-productive" public works on an extended scale, as a safe vent for all this new dynamic industrial energy.

Thus credits might flow generously to the construction of wider levees for the Mississippi and the protection of its tributaries. They might be employed to build a comprehensive system of inland waterways. They would be needed in extending the network of State and transcontinental motor highways; in systems of parks and parkways; in the Haussmannizing of cities; in the construction of vast new sources of water supply; in multiplying school buildings and plants of State univer-

---

[12] *Chase Economic Bulletin*, Chase National Bank, November 6, 1926.

[13] *Commerce Monthly*, National Bank of Commerce, New York, November, 1927.

[14] William Trufant Foster and Waddill Catchings, "Money," "Profits" and "Business Without a Buyer," Pollak Publications Nos. 2, 8 and 10 respectively.