ing system, the brokerage business and the security exchanges; second, the governmental fiscal machinery, including the tariff. All these together, and not any policies of industrial management, control the relation between saving, investment and spending which determines the flow and distribution of purchasing power, the distribution of wealth, the balance between production and consumption, the price level and the relation between creditor and debtor groups. Out of these relations the business cycle issues. The cycle is a financial phenomenon, not an industrial affair. The best proof of this is not that we did not have depressions before the modern credit system, but that we *did* have them before the industrial system.

Until this is recognized we shall make little real progress toward stability. The first and most important step toward stabilization is the social control of our financial machinery. And I believe that if this is done, almost nothing else is necessary. Given effective control of our banking system and fiscal policies, industrial management and organization may be left almost complete freedom—and the greater freedom the better. They will be able to do little damage, and the urge of individual initiative will induce advancement. In the end such initiative will serve as a constant check on concentration—which is the outcome of financial factors —and conform to the fundamental tendency to decentralization which is implicit in the physical factors underlying our economic evolution. This itself will make for greater stability.

The immediate approach to stabilization, therefore, lies along the lines of credit control and fiscal policy, not of industrial organization and planning. This is the more difficult approach because industrial planning, as at present conceived, really plays into the hands of vested interests—of creditor groups, organized labor and governmental bureaucracy—while credit control and fiscal engineering involve violent conflicts with them. The essential significance of the Soviet experiment is not its effort at industrial planning, which has serious weaknesses, but its decisive attack on the credit problem. The greatest handicap of capitalism is its archaic and ingrown credit and monetary system; that of communism is inexperience in machine technology and industrial management. These handicaps are both serious enough to make the two systems about equally matched; but machine operation and industrial management can be learned; improvement of the credit mechanism is essentially a problem of class struggle. This is the submerged issue in British politics today.

Socialization of finance in its essentials within the framework of the capitalistic system of free industrial enterprise appears almost impossible without profound political upheaval, because the forces opposed to it are so powerful; but I believe there is some promise of slow improvement, aided by the pressure of physical or technological influences now at work. This depression and the banking and fiscal situation it has given rise to afford an unparalleled opportunity for fairly rapid progress if those who understand the problem will only organize to take advantage of it.

IV

It is useless at the outset to work for any outright nationalization of our central banking system. Even in England, where the banking structure is simple, this is recognized. Public opinion is not ready for it nor are we technically prepared for governmental banking operation. Moreover, powerful private banking and investment interests are opposed to any such experiment and will be able to frighten the public, and if necessary sabotage any steps in that direction in very destructive ways. The fact is that the basis does not exist as yet for any direct governmental control over banking and investment. There really is no such thing as the Federal Reserve System, as a central banking organization. The idea is implicit in the Federal Reserve Act, which is the most important piece of economic legislation ever passed in this country, but its framers were frustrated from carrying out its full intention by the influence of special interests. We have only a system within a system, a group of powerful private metropolitan banks which control both the Reserve banks and the mass of smaller member banks throughout the country. They are the real sources of reserve credit; they are closely tied up with the securities markets; they dominate the money market; they control the only important Reserve Banks; and the mass of smaller member banks throughout the country are utterly dependent upon them, in loose ways not controlled by law, for access to reserve credit resources. Through their security affiliates, their holding companies, their chain and branch banking systems, which they are insistent on spreading, they have established an effective but invisible centralization of credit control. This control is exercised almost solely in the interest of the security markets, domestic and foreign, and not in the interest of domestic business stability, or the security of depositors. The ineffectiveness of the Federal Reserve System in this situation is sufficiently demon-

strated, I think, in the fact that in such conditions as have arisen in this depression—a practical collapse of our credit machinery throughout the country—the nominal reserve system is practically set aside, the inside, concealed reserve system is brought into the open as a National Credit Corporation; and, as will be seen when Congress assembles, it finally becomes necessary for the government to set up entirely separate and new reserve credit agencies by reviving the War Finance Corporation, as an emergency national banking institution.

I feel, therefore, that the first step toward stabilization must be the strengthening of the Federal Reserve System so that it may meet the credit needs of industry and trade in the democratic way in which it was intended to serve them. This requires revision of the Reserve Act, first, so as to ensure greater security for bank depositors and prevent the possibility of repetition of that collapse of confidence in our banks which has so seriously crippled the country during the latter stages of this depression; and second, so as to ensure greater independence and more democratic access to reserve credit resources on the part of the individual member banks throughout the country. These purposes require complete and compulsory inclusion of all commercial banks within the system; establishment of insurance reserves within the Reserve Banks to guarantee bank deposits; the widening of the provisions and regulations regarding the classes of assets eligible for rediscount. All these things parallel the proposals of the Swope plan for establishing unemployment reserves to protect workers and for strengthening the trade associations, but seem to me of much greater importance for business stability.

In addition, certain specific changes are necessary to secure greater control over the money and securities markets in the social interest. The security affiliates of commercial banks should be separated by a Caesarean operation. It should be made definitely illegal for member banks to engage in selling of securities either directly or for trust accounts; possibly the trust functions of commercial banks should be more strictly controlled or likewise divorced. Their handling of corporation funds for loan in the call market without contingent liability should be controlled. Finally, it will be necessary to establish a separate system of reserve credit resources for rediscounting intermediate and long-term loans to industry, trade, and construction, similar to the intermediate credit and land banks for agriculture. The functions of the Federal Reserve System as it stands should not be complicated by taking on these additional essential tasks.

V

These changes will make for greater business stability by providing a more elastic and controllable credit mechanism without resorting at one swoop to socialization of our banking system; but moderate as they are they will meet bitter opposition from private banking interests and will mean a long and bloody battle before they are achieved. There is more immediate promise of progress in the other half of the picture—that of fiscal policy. This is not only inseparably connected with credit control, but it is an important independent weapon for promoting stability. In fact, although I attach great importance to improvements in our banking system, I believe that more can be accomplished quickly toward stabilization by appropriate improvements in our fiscal system than in any other way.

The problem of balancing production and consumption, with which the industrial planners are preoccupied, is essentially one of increasing purchasing power for consumers' goods, rather than of curtailing output. This can be met indirectly by continuous controlled credit expansion, but this requires changes in our banking system and psychology which will be difficult to achieve, fundamentally because it involves a continuous, concealed confiscation of claims to income through inflation. Moreover, even though this difficulty were overcome or disregarded, it must remain doubtful whether we can successfully or accurately finance consumption by the indirect process of financing production, for which our banking mechanism is primarily designed. What we need primarily is a direct diversion of savings or credit capital from competitive production into consumption. We do not have to destroy profits by the wasteful process of competitive confiscation; we need only assure ourselves that they will be properly used. This result can be attained more quickly and directly by use of the taxing power than in any other way. Taxation is the most powerful weapon for redistribution of wealth and income ever devised, and by that token it is the most effective agency for stabilization. All that is required is courage and intelligence in its use.

We can, if we wish, quite simply and easily prevent over-saving, over-investment, over-expansion of productive capacity, without waiting for this purchasing power to be confiscated by competition, inflation and deflation in the cycle of boom and depression by taxing