

The bank holiday was a dramatic moment in the economic crisis. Has the government finally found a way out? This article explains the financial situation and its effect on your future.

The Meaning of the Bank Crisis

Manuel Gomez

Earthquake in California with its toll of 118 people killed and 5,000 injured, was a minor event for the United States on March 11, 1933. Its tremors were all but lost in the sense of a wider cataclysm shaking the entire nation.

Seven days before, as the first act of his administration, the President had issued a proclamation closing all the banks of the country. Money panic. Whole branches of industry at a standstill. Foreign exchange thrown into confusion. Payrolls stopped. Vague talk of scrip. The shadow of a food shortage.

These hardships carried no special significance. Farmers have been suffering privation for years; 17,000,000 workers are unemployed; the standard of living of both the urban and rural working population has been sinking steadily. What counted was not that the banks were closed but that they *had* to close. What had caused this? What did it mean for the future?

American agriculture never shared in the great period of capitalist "prosperity". As for the working class, the final two years—from 1927 to 1929—saw a three per cent increase in wages, but at the same time there was a ten per cent increase in the dollar volume of output. Thus the ability of workers to buy what they produced was actually lessened. Capitalists utilized their growing profits to expand plant and equipment with which to turn out still more finished goods. It was partly through wages paid to men working on such "production goods", and partly on the basis of credit, that the flow of finished goods into consumption was maintained on an apparently profitable basis. But such credit was being exhausted. Inventories of raw materials and semi-finished goods, on which production had begun long before they were expected to reach their ultimate market, began to pile up as the limit of the buying power of exploited workers and farmers made itself felt. A good share of the profits in 1928 and 1929 resulted in the sale of commodities not yet disposed of to final consumers.

Meantime, the capitalizations of business concerns were being expanded by leaps and bounds, partly through the investment of new funds in plant and equipment, partly through the wholesale process of "writing up" property valuations and partly through the projection of holding companies to pyramid insiders' profits. More than \$5,700,000,000 of securities were floated in 1926, more than \$7,800,000,000 in 1927 nearly \$8,500,000,000 in 1928 and about \$11,000,000,000 in 1929.*

Flotation of the large stock and bond issues would have been impossible without loans from the banks. Depositors' funds also supported the New York call money market which munitioned the speculative demand for stocks and bonds. Banking assets so disposed were considered entirely liquid, as in the case of loans on commercial paper and other similar short-term advances. But the involvement of the banks went further. A

considerable and growing proportion of their secondary reserve was invested directly in long-term bonds and in stocks.

This is a very schematic picture. It takes no note of miscellaneous "current" loans, some of them perpetually renewed, as for instance those to enable industrialists to carry swollen inventories. It leaves out of account the important commitments of the banks in the real-estate and farm mortgage fields.

If the picture were filled out it would only make more vivid the involvement of the banking system in the whole frame-work of over-extended valuations and claims against those valuations that characterized the advanced stages of American boom economy.

The Federal Reserve Board's index of manufacturing production had reached a maximum of 127 in June, 1929. By October it had fallen to 119. The setback was felt especially in the steel, automobile, and building industries. When the banks, unable to collect on advances that were to have been met in the normal course of business, found themselves obliged to restrict all sorts of new loans, and to call in money that was out, the stock market crash came. Fundamentally the market crash was a reflection of the crisis of production into which the capitalist system had already entered.

The economic crisis has deepened steadily ever since. The production index for January 1933 stood at 63. Since 1929 the national income has declined more than 50 per cent. Beggary and starvation are everywhere, while food rots or is deliberately destroyed and warehouses are bursting with commodities of all sorts. What of the exaggerated 1929 capitalizations? For the most part they still exist. The stocks and bonds and mortgages and other collateral against which loans had been placed are now "frozen assets," their realizable value far below the amount of the loans they are supposed to secure. The loans therefore have had to be carried along. The capitalists have never recognized any responsibility to the workers whose labor produces the surplus value on which capitalist economy rests. They have not even faced frankly the elementary requirements of the reconstruction of industry. Surplus value is their single-minded concern. Their reckless greed is eloquently illustrated by the continued charges they levied against a faltering productive system. Interest and dividend payments of American corporations which in 1928 totalled \$6,000,000,000 and in 1929, \$7,500,000,000, actually increased to \$8,250,000,000.** Of course much of this represented paying out



*Commercial and Financial Chronical, New York.

**New York Journal of Commerce figures, reproduced in the annual number of the Survey of Current Business, published by the Bureau of Foreign and Domestic Commerce of the U. S. Department of Commerce.

of capital. Factories were running part-time with skeleton staffs, and the actual profit stream had thinned.

After first maintaining that we were suffering only a slight business "recession", and then calling grotesquely upon the poverty-stricken workers and farmers to "buy now and bring back prosperity," American capitalism finally came forward with something like a concerted plan,—more than two years after the crisis had begun. The writer pointed out in the *New Masses* at the time that this plan, crystallized in the Hoover "reflation" program, was not a reconstruction move but a desperate effort to stave off the reckoning of debt defaults and recapitalizations, and would only make matters worse.

Up to January 31, 1933, the Reconstruction Finance Corporation loaned out \$1,707,733,473. More than \$1,280,000,000 of it was loaned to banks and railroads. Most of the railroad borrowers had to use money to pay loans to obdurate bankers (among whom were such needy gentlemen as J. P. Morgan & Company, and Kuhn, Loeb & Company) or to pay regular bond interest. Some of them even borrowed from the government to pay their taxes.

Saving Frozen Assets

With the productive machinery of the country in collapse the crisis program of the government was to keep alive the presumptive claims to wealth on the part of the capitalists. It became the savior of frozen assets. Pretending that they would be perfectly good assets "in the long run," it advanced public funds against them at face value. This helped many an insolvent bank out of a nasty situation, by spreading the risks of carrying frozen assets through the Federal Reserve system and the whole apparatus of government finance itself.

Through the activities of the Reconstruction Finance Corporation and other official agencies, the credit of the government became involved with the maintenance of fictitious valuations all along the line. The results were cumulative. Loans advanced to bankrupt railroads and other corporations to pay out interest to bond-holders were explained on the theory that bonds now held as collateral by the banks and government must be protected against default. Banks and insurance companies were encouraged to carry these bonds on their balance sheets at "conventional" values, far above what they would bring in the market. Thus many of these institutions were protected not from insolvency, but from the appearance of insolvency, while people of small means throughout the country were being urged to keep their money on deposit.

While resisting demands for unemployment insurance and adequate farm relief on the pretext of the need for economy, the government advanced such sums on frozen assets that the federal budget was far out of balance in spite of increases in taxes. Even the provisions governing the printing of the currency were "liberalized" to add loanable funds. The old law required that every dollar of federal reserve notes printed had to be backed 40 percent by gold and 60 percent by commercial and other self-liquidating paper. With business at rock-bottom, such paper was not obtainable in the desired quantity. Consequently, the currency section of the Glass-Steagall Act was adopted, providing that U. S. government securities could be used instead. The supply of government securities was virtually unlimited with the government debt amounting to something like \$20,000,000,000, as against \$15,900,000,000 two years earlier.

The writer's concluding paragraph in the *New Masses* at the time contained the following words:

"American capitalists have embarked consciously upon a program which can in no way help to solve the economic crisis but which on the contrary must intensify it. They do this because of the desperateness of their immediate situation, because recapitalization admits that the famous New Era is definitely over, because individually and collectively they are driven to postpone the tremendous losses of recapitalization as long as possible, because they are afraid of the social consequences of throwing large numbers of former capitalists into the ranks of the working class, because they have no time or ability to consider things fundamentally in the face of the immediate terror that overwhelms them. This is an election year, and added social tension cannot be risked. With all this in mind, Amer-

ican capitalism puts forward its Hoover program, not enthusiastically, not too optimistically—as the statements of business leaders will indicate—but with an intransigence born of despair."

The reflation program was really a form of attempted inflation, its only serious restraint being the provision that at least 40 percent of the currency printed would still have to be backed by gold. At the time that the Glass-Steagall Act was adopted the restraint was not considered important since the government's gold reserves were far in excess of the legal minimum. The attempt to make available vast new supplies of currency was nullified through the withdrawal of gold from the banks for hoarding. The biggest gold hoarders were the bankers themselves, many of them taking out big bars of bullion to be kept in their private safe-deposit vaults. In the last analysis the gold hoarding meant that the credit of the government was suspect. And indeed just before the bank closings, when the government borrowed money for 90 days, it had to pay $4\frac{1}{4}$ percent interest; it had been able to negotiate such short-term borrowings at a fraction of 1 percent only a few months previous. The policy of trying to support fictitious valuations was producing inevitable consequences. The bank crisis was a result of the contradiction between declining industrial production and insistence upon swollen capitalist claims against the productive system.

The first outward sign of an acute banking and currency crisis was the news that the peculiar public holiday declared in New Orleans (ostensibly in commemoration of the anniversary of the severance of diplomatic relations with Germany) was really an invention of Huey Long to provide a breathing spell for large New Orleans banks that were unable to satisfy their depositors. On February 14 all the banks in Michigan were closed for eight days by sudden extra-legal proclamation of the governor. Word leaked out that the foremost banks in Detroit were in trouble. There were similar closings in Minnesota and New Jersey. Maryland followed. In a little more than a week's time, 22 states and the District of Columbia were having "legal holidays" or banking "vacations." As funds were rushed from other centers to provide currency and gold in the affected districts, the home situations became weakened. Lines began to form in front of the savings banks in New York City. Complete national shutdown followed. Everywhere there had been a demand for currency instead of titles to currency, and for gold in preference to bills. Neither gold nor bills were available. Only \$1,000,000,000 additional currency could have been issued under the 40 percent gold clause and currency was being withdrawn from circulation at the rate of well over \$200,000,000 a day!

Capitalism Unprepared

Characteristically enough, capitalism had been totally unprepared for the banking crisis, even while individual capitalists were hoarding gold. The accepted belief was that "the panic phase of the depression" had been passed last July with termination of the gold movement to Europe, and that there was no danger of a recurrence. Similarly, there is a disposition now to speak of the banking crisis as "the low point of the depression". Speculators, pointing to the gold that is being returned from hoarding under the threat of jail sentences, declare that "the air has now been cleared," that indeed as a result of the crisis the economic system is already on the road to cyclical recovery.

Just what has changed? Department store sales for February, the latest reported, were 25 percent less than in February of last year. Electric power consumption exhibited a drop of 8.4 percent. In every one of the 16 industries included in the Federal Reserve Board tabulation, employment shows a substantial reduction. As to the outlook for the period ahead, unfilled orders are at unusually low ebb except in one or two of the lighter industries. Those of the steel industry, for example, are at the lowest point in history. World supplies of copper above ground, at 1,000,000 tons, are greater than at this time a year ago, or even four years ago. Lead, petroleum, rubber, cotton, and other raw materials afford the same general picture of over-production. This state of things has not been altered as a result of the banking crisis except that it has been

accentuated. It is hardly a base for a firm upturn in production along capitalist lines.

Of course there have been changes in other, less fundamental, respects. Of the 18,000-odd banks in the country, about 3,000 are now closed, some of them permanently. Small depositors throughout the country have lost their life's savings. International trade calculations have been disrupted, and tariff intricacies accentuated. And no one can say how much or how little a dollar bill will buy six months hence.

The most signal change wrought by the banking crisis is that it has forced outstanding capitalists to consider more comprehensive tasks than the validation of frozen assets. Theoretically, at least, they realize they can no longer hold on to the New Era. They acclaim the New Deal in its place because, frankly recognizing the existing collapse, it nevertheless proceeds from the assumption that the postulates of capitalism remain valid and moves energetically to organize its still-utilizable points of support. By going ahead in this way the New Deal has been able to solve the immediate technical banking crisis. It has not solved anything else—and what it has achieved can scarcely be termed a solution in any but a superficial sense. But it has delineated a type of strategy in which the capitalists are ready to place a certain amount of hope.

For all its Home Loan Banks and Railroad Credit Corporations, and despite the paradox of the Federal Farm Board's operations, the Hoover policy was essentially one of placing government funds at the disposal of private capitalist enterprise. The Roosevelt policy asserts the authority of the government over the claims of individual groups of capitalists. It is the most drastic peace-time step in this direction in the history of the country. In substance it is the will of the biggest capitalists that is to be imposed. They may be called upon to make some apparently difficult compromises—as in the case of Roosevelt's agricultural bill—though that measure is temporary in its proposed application and just how it will actually be put into effect remains to be seen.

It is instructive to note that precisely at the time when the agricultural bill in its original form was under critical discussion in Congress, the following comment made its way into the column edited by Eugene M. Lokey in the financial section of the *New York Times*:

"There is—no matter what the surface indications may be—nothing of the 'tongue-in-cheek' attitude about Wall Street's enthusiasm for the new President. As matters stand now, the financial capital is delighted to have him go as far as he likes in the direction of rehabilitation and readjustment. His program, while it may have reflected a spirit of audacity at times, has been sufficiently orthodox in the broader financial sense to win vigorous support from Wall Street, as the comment of the last week has plainly indicated."

The general outlines of the Roosevelt program were suggested in the President's inaugural address. They began to be concretized in the Emergency Banking Law and the so-called economy law, the proposals for which were greeted editorially in the *Wall Street Journal* as follows:

"The President's two messages constitute an emergence of real leadership, and as such are refreshing and encouraging in the highest degree. They give solid ground for the hope that, whatever yet remains to be done, the cornerstone of national recovery has at last been laid."

The beer bill and the agricultural bill came next. The President has announced that his immediate program will be completed with an unemployment measure, legislation for railroad consolidation and recapitalization, and a bill dealing with farm foreclosures. At the present writing, bills covering these specific points have not yet been presented but the administration's plans with respect to them are more or less known. Thus, in its essentials, the program is already before us.

Central importance in the scheme belongs to the Emergency Banking Law. The other measures can be best understood by considering them in connection with a discussion of this law. Its objectives group themselves naturally under five heads:

I. *Concentration of gold under Treasury control.* (Banks required to deposit their gold at Federal Reserve depots and take paper currency instead; severe penalties against gold hoarding; control of gold movements and foreign exchange by the President).

II. *Transition to a "managed" currency basis now, to-*

gether with inferential adherence to the gold standard for the future. (Authorization of new currency to be issued exclusively with paper backing such as government bonds or any notes, drafts, bills of exchange, or bankers' acceptances in possession of the Federal Reserve banks; this new currency, known as Federal Reserve Bank Notes, to be taxed and to be limited to the emergency period).

III. *Concentration of banking control under the federal government.* (Federal Reserve member banks permitted

to transact business only under regulation and prescription of the Secretary of the Treasury "to provide for safer and more effective operations"; independent state banks to be forced into the reserve system through the pressure of the foregoing implication of added safety, as well as by the inducement of easy rediscounts, etc.).

IV. *Elimination of the weak spots in the banking system.* (Banks allowed to reopen only under special license; Comptroller of the Currency authorized to appoint con-

servators, or receivers, for national banks whenever he deems it advisable).

V. *Maintenance and extension of banking services to the fullest extent commensurate with elimination of weakness in the system.* (Reconstruction Finance Corporation may advance funds to national or state banks for their organization or their reorganization, and may even purchase their preferred stock and take over effective ownership—much as the German government took over the



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Danat and Dresdener banks; hitherto ineligible paper made acceptable for rediscount; Federal Reserve banks authorized to make loans on government bonds direct to any individual, partnership, or corporation).

What stands out most prominently is the predominant position of the government in the scheme. Similar extraordinary powers are reserved to the executive in the "economy law" and in the proposed agricultural bill. Centralization is also a feature of President Roosevelt's unemployment program. Incidentally, the concentration of the banking system is not simply a matter of the relation of banks in general to the government; it involved consolidation of the hegemony of the big banks over the smaller ones, extension of branch banking, etc.

Much discussion goes on as to whether or not the Roosevelt program means inflation. There is no simple answer. Everything is in the hands of the President insofar as the laws are concerned. What construction he will place upon them and what he will do under the broad powers that he has obtained will depend on the impact of the objective forces, social and otherwise, which are called into play in the process.

The end sought in the Emergency Banking Law is plainly not inflation but deflation. This becomes all the more apparent in connection with other recent expressions of federal policy, from the amendment to the bankruptcy law which facilitates scaling down of railroad and other capitalizations (adopted in the last few days of the Hoover administration with the concurrence of Roosevelt) to the measures for balancing the federal budget at the expense of veterans' pensions, civil service salaries, etc. It is borne out by the stipulation that the Treasury Certificates dated March 15th are to be "payable in the United States gold coin of the present standard of value."

Deflation involves the shutting down of more factories, the precipitation of more unemployment, the further reduction of real wages, the augmentation of debt burdens. It means wholesale business failures, panic among the petty bourgeoisie, intense suffering and turmoil. Its implications are all the more violent as a result of the Hoover epoch. To provide an offset against extreme repercussions, the Roosevelt program is prepared with certain palliatives. In this category are the so-called farm relief program, the anti-foreclosure schemes, the Tennessee River Valley development proposals, and the innuendo of the President's repeated references to "a sound but adequate currency." The need for safeguards also accounts for the flexible formulations given in the Emergency Banking Law and other recently adopted measures.

Toward Inflation

The flexibility of the program is important in that it creates the possibility of the deflation effort leading into inflation—in spite of itself.

The most frequently cited instance of a potential inflationary source is the provision for issuing new currency under the Emergency Banking Law. The provision was necessary because of the failure of the old gold-backing arrangement to furnish sufficient currency against emergency. It was not adopted for purposes of inflation, and its adoption is not synonymous with inflation. At the time of the March 4th bank closings, the amount of money in circulation exceeded \$7,000,000,000 but bank deposits totalled \$43,000,000,000. Only \$2,000,000,000 of the federal reserve bank notes are being printed, and only \$6,840,997 had been placed in circulation up to March 16. Speaker Rainey has declared that the government might conceivably issue \$11,000,000,000 of the bank notes—but the mere issue of these bank notes, so far as they are handed to individuals in exchange for deposits they now hold in banks, would not add to the means of payment in the country, and would not mean inflation. Nevertheless, the fact that there is virtually no limit to the amount of federal reserve bank notes that may be issued under the present law makes inflation an ever-present possibility, notwithstanding a "favorable" foreign trade balance and a jealously husbanded store of gold.

The administration has just disposed of \$800,000,000 of very short-term government securities to banks, to be paid for by crediting the government with bank deposits for the proper amount. If it should be necessary to feed out considerably larger issues of securities in this way, and the process should continue over a period, the inflationary implications would be un-

mistakable. The administration has no intention of pursuing this course; its various agricultural-price measures are supposed to pay for themselves and the elaborate Tennessee Valley project has been put off in favor of isolated reforestation activities with 250,000 workers to be herded in concentration camps and paid the unspeakable wage of \$1 a day,—not an effort at unemployment relief but an attack against wage-scales. But the pressure of events and the give and take of the class struggle are like to force revision of any calculations that have been made as to prospective expenditures. Roosevelt recognizes that he must at least consider a general public works program costing far more than would be available as a result of selling "baby bonds" direct to the public. Even as it is, the items of the federal budget that the President proposes to balance do not include the "emergency outlays" of the Reconstruction Finance Corporation. These outlays are expected to be curtailed in one direction but they are being expanded in others. If they are to be stretched to cover everything from assisting food processors to putting the government into the banking business on a large scale as a joint stockholder with private capitalists, they might well make the Hoover money drain look meager.

Not that there are not perfectly sound methods of raising money in vast sums in the United States of America. Here are some of them: a levy on capital; a doubling of inheritance taxes and of gift taxes; cancellation of tax exemptions on government bonds; increase of income taxes in the higher brackets. Funds raised in this way could finance truly important unemployment and farm relief programs. This would not be inflation but the government fails to be interested nevertheless.

Incidentally, the provisions of the banking law that make re-discounting easier at the Federal Reserve, while logical enough as part of a deflation program in which all weak banks are to be weeded out under the most rigid government supervision, are fraught with inflation possibilities if the supervision should turn "lenient"—as is almost certain to be the case in the light of the turbulent alternative of thousands of country bank failures, to say nothing of the pressure for bailing out insolvent big city banks. There are signs of such leniency. Independent state banks are being allowed to operate at the discretion of the state authorities. Banks not members of the Federal Reserve system are being invited to borrow from the Federal Reserve on dubious collateral. Our old friend, frozen assets, bobs up again in the utterances of Senator Vandenberg of Michigan, who says: "I insist that in the construction of the word 'sound' the banks shall not be tied to the dead bodies of today's values." That is why more than 15,000 banks are still open and why there are several states in which not a single bank is closed.

If the government, with all its extraordinary powers, must temporize at this stage, how successfully would it be able to withstand the convulsion of social forces that the advanced application of its deflation line would produce? What we have now is a deflation offensive, equipped with the machinery of compromise and trying its way slowly along a zigzag path. Inflation is not to be considered an immediate probability. The longer-term outlook suggests a different story. Inflation, once out of control, would rush forward swiftly to its climax in this country, where the existing overproduction of commodities and overdevelopment of productive capacity make impossible any such sustained speculative booms as commodity-exhausted European countries experienced in the post-war inflation days. It would end in a more catastrophic crisis than we have yet seen, and in deflation.

Thus both deflation and inflation come to the same thing in the end. Both place intolerable burdens upon the masses. Both imply terrific shocks to the whole socio-economic system. Only with the machinery of dictatorship in readiness could capitalism plan to face them. Whether, as seems unlikely, it will proceed vigorously with deflation steps, or whether in practice it will find itself reduced to warding off inflation and operating flexibly to hold things to the current miserable status quo while war plans are ripening, the hint of an ultimate appeal to the methods of fascism if deemed necessary, is inherent in all that is being done. The Roosevelt program as outlined in law is a daring and shrewd one, to organize capitalism against itself and against the masses. But the task is too great. In the end there will be nothing but continued stagnation, war or social tumult.