EXTENSION OF PRICE CONTROL HEARINGS

HOUSE COMMITTEE ON BANKING AND CURRENCY

H. R. 5270

House of Representatives,
Committee on Banking and Currency,
New House Office Building,
Washington, D. C.,
February 25, 1946.

The Committee reconvened at 10:30 o'clock a.m., Brent Spence, Chairman, presiding.

The Chairman. The Committee will be in order.

Chairman Eccles of the Federal Reserve Board is our witness this morning.

We are always glad to hear from you, Mr. Eccles. Have you prepared a statement?

Mr. Eccles. I have a short prepared statement, Mr. Chairman, but I finished it only this morning, and I have not had time to have it mimeographed. I hope to have the mimeographed copies up here later.

The Chairman. Would you like to conclude the reading of that without interruption and then subject yourself to interrogations?

Mr. Eccles. Yes, sir.

The Chairman. All right. You may read your statement without interruption, and then subject yourself to questioning.

(Statement then read by Chairman Eccles)

I appeared a year ago -- approximately a year ago -- in connection with the renewal of this Emergency Control Act, and I am going to quote just a very short statement that I made at that time, because it bears so directly

upon this question.

Appearing before the Senate Committee at that time, I made this statement:

"Inflation seldom gets out of hand during war time. But the danger carries over after peace comes, and a war-weary people, tired of wartime controls and restraints, are eager to throw them off. That is just the time when it may be fatal to relax prematurely the controls of war engendered inflationary forces. That is why it is so important to extend the life of this legislation for a sufficient period after the war to enable the country to convert its enormous productive capacity to turning out, for peacetime consumption, a supply of goods comparable to what it has shown itself capable of turning out for war purposes. If the public is led to believe, however, that the price, wage, and rationing controls are going to be eliminated or weakened, or not continued as long as may be necessary, confidence cannot be maintained in the purchasing power of our money. Without confidence, not only would the successful prosecution of the war be jeopardized, but an orderly transition to a peacetime basis would be out of the question."

That still applies today.

That, Mr. Chairman, completes my statement.

The Chairman. Mr. Eccles, I judge from your very excellent statement that you think that the economic pressures that make for inflation are as strong now as they have been at any time?

Mr. Eccles. I think they are stronger, Mr. Chairman.

The Chairman. How long do you think the controls should be continued?

Mr. Eccles. Well, I would say the Act should be extended for at least a

year. I suggested, a year ago, that the controls be continued two years after the war, that the legislation be enacted at that time should be extended for two years after the war, so that the public would not be waiting for the controls to go off, and would adjust itself and learn to live with them, realizing that they would be discontinued as soon as the various factors came into balance -- that they would automatically work themselves out.

Certainly, at this time, any less than a year's extension would be a very great mistake, because there would likely be considerable waiting until the controls went off, in order to get higher prices, and instead of getting goods into consumption, you would likely find, in many instances, where they were held back in the form of excessive stocks of raw materials, semi-finished products, and finished products, and that, of course, would greatly add to the pressures.

The Chairman. Mr. Brown, do you have any questions?

Mr. Brown. Yes, Mr. Chairman.

Mr. Eccles, do you agree with me that full production is the best weapon against inflation?

Mr. Eccles. Yes, it seems to me it is the only effective weapon. I do not mean by that that we must not stop the expansion of the means of payment.

Mr. Brown. I understand. Now, do you agree with me that we should encourage those engaged in production and not discourage them?

Mr. Eccles. I think they should be encouraged. I think they are being encouraged.

Mr. Brown. Well, I am just asking you whether you think they should be, Then, it strikes me that we should get together on the best ways of

encouraging production.

Mr. Eccles. That is right.

The Chairman. But, Mr. Eccles, production itself will not eliminate the danger of inflation until production has supplied the necessary goods and services which the people demand; is that not true? I mean the commencement of production, even full production, would have no effect on the inflationary conditions until production has produced what the people desire to buy?

Mr. Eccles. That is correct.

The Chairman. And we ought to retain these controls, as I understand it, until we have produced the goods that would eliminate the dangers of inflation. It would be hazardous to discontinue them just because you are in production, when production has not yet produced what the people desire?

Mr. Eccles. We must retain, in my opinion, the controls until we greatly increase the supply of goods and services that the people want to buy and until there has been some opportunity to catch up with the backlog. But while we are doing that, we must not undo the benefits of it by further expanding our money supply.

The Chairman. Mr. Crawford.

Mr. Crawford. Mr. Eccles, I think that last sentence of yours should be added to your direct reply to Mr. Brown's question with respect to production. If the answer to inflation is through production primarily, we must discontinue these inflationary forces as you have pointed out, along with the stepping up of production.

Mr. Eccles. That is correct.

Mr. Crawford. In other words, we might step up production very, very

materially, and if we still continue to broadcast inflationary forces, we will certainly be operating in opposite directions.

Mr. Eccles. We would be trying to go in two opposite directions at the same time.

Mr. Crawford. Yes, sir. Now, I have three or four more questions. Along the same lines, the other day I submitted this question to Mr. Bowles. I would like to get your answer on it, as direct as you can make it. And I will read from the official transcript so that the language I submit to you will be exactly that which was submitted to Mr. Bowles. "So long as you are Administrator, do you take the position that these controls should go off as we bring supply in balance with demand, or do you take the position that the controls should continue as long as there is a great backlog of pent-up buying power, which, in the absence of control, can be exercised by the citizen at his will?"

Now, that is the question I submitted to Mr. Bowles. What prompted that question primarily in my mind was his numerous statements about the forces of inflation and the disasters that would come to us if those forces were not somewhat modified or controlled. I think you have given us the finest direct statement as to the volume of these inflationary forces which we have presented to the Committee. So I would like to submit this question to you now, in line with what you have already stated. Do you take the position that the controls should be continued until supply comes into balance with demand -- I mean, practically speaking -- or do you take the position that these controls should be continued as long as we have that pent-up buying power which constitutes these inflationary forces, as you have defined them?

Mr. Eccles. I think we should maintain controls until the supply comes

into balance, or reasonable balance, with the demand.

What we term the pent-up inflationary forces or the inflation potentials, as measured by the deposits and currency and Government securities, are not likely to create inflationary problems if the supply of goods is in reasonable balance with the desire of the people to purchase, and their money will be held in Government securities, or in savings deposits, or in currency, or they will invest it, possibly, in further Government securities, and if we have a balanced budget -- which we should have -- and a surplus, then, the bank holdings should diminish as the public invest their currency and deposits in Government securities. Because if the Government is not requiring additional deficit financing, we should see to it that it is the bank securities that are reduced, and the public investment increased, that we should have been very much better off during the war had we been able to accomplish that during the war.

Now, to the extent we can reverse that, we can very well keep this potential, without having any inflationary effect.

Mr. Crawford. Now, you mentioned extending the Act for one year. Based upon the information which is available to you as Chairman of the Board of Governors of the Federal Reserve Board, do you think it is reasonable for us to assume that the supply of goods will be in balance with demand by July 1, 1947? That is, to the practical degree that is necessary in connection with this legislation?

Mr. Eccles. Well, that, of course, will depend on the extent to which this wage-price policy is effective in bringing about production. Certainly we have demonstrated that we have the capacity to produce enormously, and if we can take the civilian production during the war, and add to that the war

production, converting that into civilian goods, it would seem to me that, with some exceptions, we should be able to meet, pretty largely, the demand, so that the public would not be likely or willing to follow prices up.

In the construction field, there is no question but what, for some time, there will be a great shortage, and I think that building permits to determine what may be built may have to be kept on for some considerable time. That prices of scarce building materials will likewise have to be controlled. It may be that there will be some other items -- I have in mind, for instance, automobiles. I cannot imagine that the supply-demand factor in the automobile field can be met within a year from this time.

But, generally speaking, in the clothing field, in the food supply -- if we get good crops this year, all right; if we do not, that changes the picture -- but if we get abundant crops, and there should be an adequate supply of food and clothing --

Mr. Crawford. What would you say about household appliances?

Mr. Eccles. I think that will be pretty largely met. The capacity to produce is simply enormous in that field.

Mr. Crawford. Then, would it be fair to summarize your thought something like this: that in the event that within 12 to 18 months we do bring these products which people must have, and so greatly desire, largely into balance as regards production, supply and demand, and if we do some of these constructive things with respect to stopping the spread of inflationary forces which you have recommended that within 12 or 18 months we might reach a point where these controls could be very generally removed?

Mr. Eccles. Yes, I think we can do just that.

Mr. Crawford. That that is the procedure to be followed, although we may have, within the hands of the people, a very large pent-up backlog of buying power of perhaps one hundred or two hundred billion dollars, but which would not be crowding into the market be reason of the things you point out?

Mr. Eccles. I certainly think that is true. That, however, as I say, is dependent upon the price-wage policy.

Mr. Crawford. Very much so.

Mr. Eccles. Upon that policy succeeding, and likewise upon certainly a balanced budget, and, if possible, a surplus. Now, that cannot be accomplished if we are going to start reducing taxes at this time, and it does not seem to me to make very much sense to maintain inflationary price controls, and other controls, while, at the same time, we increase purchasing power by reducing taxes.

Mr. Crawford. I think that is a very sound statement.

Now, I have two other questions on that same subject, but which are tied to your statement issued on January 17, when the Board of Governors of the Federal Reserve System increased margin requirements to 100 percent, in order to dampen speculative activity of the stock market. And I want to read two very brief paragraphs which appeared in your statement as published in the February, 1946, issue of the Bulletin: "In addition, it is important to point out that so long as the public debt continues to be monetized through the purchase of Government securities by the banking system, the supply of money will continue to increase, thus tending further to reduce the interest rate on savings and investment funds. The resultant pressure of an increasing money supply, and of lower interest rate, is bound to have a further inflationary effect upon all capital assets, and to increase the difficulty of

holding down the cost of living. It is, therefore, imperative that the process of further monetizing of the public debt through the banking system be ended, so that the rate of return on investments would be stabilized, and would reflect the supply of savings and investment funds in relation to the demand instead of reflecting an increasing amount of bank credits. This process needs to be stopped, not only by bringing about a balanced budget, but also through measures to check further unnecessary expansion of commercial bank holdings of Government securities."

I think that conforms very much to what you have said this morning. Now, my two questions on that point are these: first, what has been done since this statement was issued to keep the interest rates from going still lower?

Mr. Eccles. Well, there has not been anything done.

Mr. Crawford. In other words, we are still marking time on that?

Mr. Eccles. That is correct. I would say that the announcement of the Treasury to pay off, out of their balances, one billion dollars on March 1st, of Treasury Certificates, and around a billion dollars of 1 percent notes, and four hundred some odd million dollars of 3-3/4 percent bonds, on March 15 -- a total of $2,800,000,000 -- is in the right direction. The Treasury raised, in the Victory Drive, far more money than it needed, and they are, therefore, likely to find that they will be able to reduce substantially the debt during the next year -- as started in that process. The Federal Reserve agreed fully with that first step of the program.

That is a mild step in the right direction.

Mr. Crawford. The general fund is now about 24-1/2 or 25 billion dollars,

is it not?

Mr. Eccles. That is correct.

Mr. Crawford. Now, the other question I have on this same thought is this -- and this gets into matters of high policy and you may not want to answer it. Is the Board, or are you likely to eliminate the preferential rate of 1/2 percent on advances by the Federal member banks secured by the Government with maturity of less than 1 year?

Mr. Eccles. Well, the initiation of that, of course, comes from the twelve reserve banks. They must propose the elimination of that preferential rate, and then it is up to the Board to approve. Of course, it would be rather premature for me to speak for the 12 banks and to speak for the Board members, as to what should be or would be done in that regard. I can say this, however, that the rate was put into effect as a war measure, to help finance the war. It was put in in 1942, to make it easy for the banks to get reserve credit, so that they could purchase such Government bonds as was necessary to assure the financing of the war at the low interest rates that it was determined it should be financed on.

We were undertaking an unprecedented financing operation, and with the raising of close to 60 billion dollars in one year, which we did, as I recall, in 1943 and 1944, nobody had ever dreamed of such an undertaking, and we had to assure the Treasury that their financing would have to be eminently successful, and the door to the Reserve banks was opened so that the banks could create reserves at a favorable rate.

In my opinion, the need of that rate has ceased to exist as of the end of hostilities, and it only serves to indicate to the banking system that they

can get funds from the system with great ease, and thus enable them to buy more securities in the market. As you know, for each dollar of Federal Reserve funds that are furnished the banks, they can buy $5 worth of securities in the market.

It tends, in other words, to encourage rather than discourage the creation of more bank credit. That seems to me to be the effect, if that has any effect.

Eliminating the rate in no way would increase the cost of Treasury financing. The rate is not necessary to maintain the rates which the Treasury now pays for money. Those rates would be maintained by open market operations.

I would like to point out, however, that the banks have used, to quite a limited extent, the discount privilege on the preferential rate. I think at the present time there is only a little over 200 million dollars of credit extended to the banks on the basis of that rate.

Mr. Crawford. Dr. Smith wants me to ask you what the rate is.

Mr. Eccles. What it is?

Mr. Crawford. What rate you speak of? One-half of 1 percent?

Mr. Smith. What is this rate?

Mr. Eccles. Half of 1 percent. On Government securities maturing in less than one year -- one year or less.

Mr. Smith. Is that the rate that the Federal Reserve pays the banks?

Mr. Eccles. No; the banks can borrow from the Federal Reserve on Government securities that mature in one year or less at 1/2 of 1 percent.

Mr. Smith. That is the figure I wanted.

Mr. Eccles. Yes.

Mr. Crawford. Mr. Chairman Eccles, did I pick up from your statement

which you read there some reference to the inflationary effect that would follow should we, in making loans to foreign countries, carry the transactions through the Treasury, selling the bonds to our people, or to the banks? What did you say on that?

Mr. Eccles. Well, I made this point: to the extent that credit is created through the banking system -- either an expansion of domestic credit or foreign credit --

Mr. Crawford. That was my point.

Mr. Eccles. Either of them will add to the supply of money, and that, to the extent that foreign credit may be extended by the banking system, or domestic credits are extended by the banking system, to the extent that the Government extends foreign credits, and, in turn, finances those credits through the banking system, it creates money.

Mr. Crawford. Would you care to briefly comment on whether or not there is any other practical method of financing, as will say, the British loan, other than through Treasury transactions?

Mr. Eccles. I do not think there is any possible way of meeting the thing except in that way. However, I would like to say this, in connection with the British loan; it is something that will extend over a period of years. The impact of that does not come all at once, by any means.

Mr. Crawford. All right. Thank you.

The Chairman. Mr. Patman.

Mr. Patman. Mr. Eccles, in giving the different amounts of money now in the hands of the public, or liquid assets, you took into consideration, I guess, the amount of money in actual circulation today?

Mr. Eccles. That is right. I took it as of the end of the year. It was

as of December 31.

Mr. Patman. About how much was it then; about 28 billion dollars?

Mr. Eccles. You mean in circulation?

Mr. Patman. Yes, sir.

Mr. Eccles. About 28 billion dollars.

Mr. Patman. How do you account for that large amount of money being in circulation? That is about four times as much as we ever had in circulation up until this war.

Mr. Eccles. That is right.

Mr. Patman. How do you account for that? Why would people draw out so much money in actual cash?

Mr. Eccles. Well, there are several combinations of reasons.

First, prices are higher. It takes more money to do business.

Mr. Patman. Now, which prices?

Mr. Eccles. Consumer prices as compared with 1940 are possibly -- oh, I do not know, some estimate 30, 35, or 40 percent higher than they were then.

Mr. Patman. Well, that is bound to be on certain prices.

Mr. Eccles. I am speaking of the cost. Some are 60 percent higher, some are 20. I mean the average increase in the cost of living is estimated to be between 30 and 40 percent.

Mr. Patman. All right. Well, that would account, say, for a 40 percent increase?

Mr. Eccles. That is right.

Mr. Patman. Which would be very small in comparison with the large amount in circulation.

Mr. Eccles. Well, that would be maybe 3 billion dollars from that source.

Mr. Patman. Yes, sir.

Mr. Eccles. Then, the payrolls are very much larger than they were prior to the war. You have 53 million employed, and the wages they get are higher. We have substantially more employed and the weekly pay is substantially greater. So that would account for -- I have not estimated the exact amount, but it would account for a good many billion dollars, the increased wages and increased employment.

Mr. Patman. All right.

Mr. Eccles. Another factor in the increase is that more people are away from home. The soldiers and workers. There was a great shifting and moving of people from the place that they would consider their home and where they had banking connections, where they carried savings and other accounts, they carried more money -- a good deal more money in their pockets, in their purses, than they would have done had they not been moving around, or had they been located in their original homes. We figure that is an important factor.

Another factor is that the bank service charges, I think, increased the amount of currency in use rather than checking accounts. I think that is to good, but to the extent that these bank accounts were small and the number of checks issued were considerable in number, the accounts were not only undesirable but they certainly were carried at a very substantial loss, and with the increased cost of doing business, with the great labor shortage, to the extent that they reduced or cut down the total amount of small checks, it was a sound development. That was no doubt a very substantial factor in increasing the use of currency and took the place of a great many small checks.

Then, there are two other important factors. The black market operations carried on in currency -- which are harder to follow -- and those, of course, during the war, have been quite substantial.

And tax evasion is another item of very substantial proportions, and that would result in a substantial increase in currency.

Then, I think there is some -- I do not know what amount -- that is held by foreigners, who have great confidence in America and the American dollar, and where it is impossible to get gold, they felt that this was the best currency, and wherever they have been able to get hold of it, I think there are some foreign funds carried in currency.

The amount outstanding, taking into account all of these factors, is not at all alarming. The upward trend of currency expansion seems to have ended, and for the first time it has seemed to turn downward.

Mr. Patman. I notice in one period some 500 million dollars.

Mr. Eccles. Well, it is down about 700 million dollars since the end of the year. That is a natural trend. Even last year, for the first two weeks, there was a downward trend, because during the holiday period, when the shopping is great, there is always an expansion of currency, but after the 1st of the year it flows back into the banks, out of circulation. But this year the downward trend has continued, and it has not turned upward as it did a year ago about in the middle of January, it is our feeling that if we hold this line, prevent inflationary developments, that there is not likely to be any material further expansion of currency.

Mr. Patman. Now, you mentioned two things there: tax evasion was one of them, and the other, black market operations. Both will contribute towards

inflation. I believe you will admit that?

Mr. Eccles. That is right.

Mr. Patman. Have you given consideration to any plan by which you might minimize these two operations?

Mr. Eccles. Well, I have not. The responsibility for that, of course, in the tax field, is up to the Treasury.

Mr. Patman. I have an idea, though, that you have personally given it some consideration, have you not, Mr. Eccles?

Mr. Eccles. Well, I have, yes, but I think it would be inadvisable to discuss either of those questions.

Mr. Patman. Well, suppose, just for the benefit of the Committee, you would tell us just what you think could be done that would be helpful in that direction?

Mr. Eccles. I do not feel that I am qualified, Mr. Patman, to express views on that subject, because there are a good many aspects to it.

Mr. Patman. Well, I will not press you.

Mr. Eccles. I believe that the Treasury, on this question of tax evasion, is making quite a drive. One of the difficulties, of course, during the war, was that it was practically impossible to get competent people in the Internal Revenue Bureau. So many men were taken out by the draft, and the volume of work of the Bureau was tremendously increased, so that the job of inspection and the job of supervising the tax collection work was terrifically handicapped. But with the end of the war, and an adequate supply of personnel available -- and I understand Congress has furnished the Treasury with such funds as they need to employ extra inspectors -- I think without question they can do

a great deal in stopping the tax avoidance, and in collecting some of the taxes that should have been paid.

Mr. Patman. I notice where you raised the requirements to purchase stock. You eliminated the margins, in other words, in stock purchases?

Mr. Eccles. Correct.

Mr. Patman. Is there anything else you could do towards retarding the stock market?

Mr. Eccles. There is nothing else we can do except to eliminate.

Mr. Patman. Have you made any recommendation or any plan that you would care to discuss that would be helpful along that line?

Mr. Eccles. I made a recommendation a year ago last January.

Mr. Patman. That is right.

Mr. Eccles. Before the Senate Banking and Currency Committee, when this question came up, and I have made the same recommendation upon several occasions in connection with the work of the Stabilization Committee, the Economic Stabilization Board, of which I am a member, an advisor. And in this statement that was released to the press -- I happened to bring a copy of it along, thinking this question might come up -- this is what was said:

"The most effective way that I know of to curb speculation in capital assets would be to increase substantially the rate of the capital gains tax, or the holding period, or a combination of both. For a long time I have advocated enactment of legislation to this end as a temporary protective measure applicable to all future purchases. This would not deter the selling of assets held at the time that the measure was introduced in Congress, but it would greatly deter buying for the speculative rise after that date. It

would not affect the purchase of capital assets of any kind which have been or are being bought for personal use or a long term investment, rather than for the speculative rise."

Mr. Patman. I recall that testimony, and I think you are right about it. I think one of the greatest mistakes we have made was reducing taxes so soon and so much, and I think we should have gotten more as we went along, and I think we should have increased the capital gains tax for the reasons which you have suggested there. It would have been helpful.

Now, one other thing and then I will be through, Mr. Eccles. You mentioned that if we did not curb inflation, that there would be a flight of the dollar. That people would use their liquid assets to buy things. What do you suggest they would buy? Stocks, real estate, and things like that? Things that might increase in value along with the decrease in value of the dollar?

Mr. Eccles. That is right. That money, or debt forms, such as mortgages, bonds, Government and otherwise, are, of course like money, and their value diminishes with the decline in the purchasing power of money. I do not mean their price declines, but I mean the dollars they are payable in decline. So that people are always looking for a hedge against inflation, and the stocks -- preferred and common -- real estate -- all kinds, farms, homes, business properties -- and commodities, of course, are away to hedge against inflation, and the records in Europe, where there has been an excess supply of money and scarcity of goods available, such as is the condition today in most of the European countries, show that there is a great pressure for prices to go up,

and I think that our stock market, our real estate, homes, farms, and even commodities that can be bought, could skyrocket if this price control act were not extended, and vigorously enforced, and unless we maintain taxes and balance the budget and maybe pay off some of the debt and unless we stop the banks from creating additional money.

Those are, I think, the things we must do to stop this potential from being effective in its inflationary effect, and to cause the public to maintain the confidence that they have today, and justifiably so, in our money. And to the public, money is savings accounts, Government bonds, insurance policies, retirement funds, and so forth. And it seems to me that we have a terrific responsibility -- this Government has -- to see to it that those funds, those investments in insurance, and in savings, and in Government bonds, are protected, and that their purchasing power is protected.

Mr. Patman. What do you consider the value of the dollar to be today compared with the period immediately preceding our entrance into the war?

Mr. Eccles. Well, of course, there is a good deal of argument as to what our inflation has been. Measured by the increase in the cost of living, I think the Office of Price Administration figures that it is about 30 percent inflated. Which is as good a job as any country has done. I think maybe Canada has done, if anything, a little better job than we have. But with other countries, there has been a greater inflation than that. I would expect that with increased wages and prices on your new wage-price policy, that we will get some further increase. It is estimated that there is a possibility of it reaching as high as a maximum of 40 percent. I would think, if the

cost of living can be held to 40 percent above the prewar level, that we will have done a fairly good job considering the size of this public financing that has been undertaken.

Mr. Patman. You were not here when we were considering the Housing Bill, which is considered an anti-inflationary bill. Have you given consideration to the fixing of prices on existing homes?

Mr. Eccles. Yes. I have been in a discussion or two where that matter has developed. The difficulty with that particular field is that it is a job of enforcement. Theoretically, I think it is fine, if it could be made to work. But the job of enforcement is going to be a particularly difficult one. Of course, as I understand the proposal, it is to freeze the price of a home after its second sale.

Mr. Patman. The first sale after the law passes.

Mr. Eccles. That is right. That is the price. From then on, it is frozen at that price.

Mr. Patman. During the emergency.

Mr. Eccles. That is right. Of course, that would keep the home from being sold a second and a third and a fourth time for speculative profit, but, of course, it would not keep it from selling at an inflated price the first time.

Mr. Brown. Mr. Patman, will you yield?

Mr. Patman. Yes.

Mr. Brown. Now, I do not know a home anywhere that you could get as much for as it would cost you to buy the lot, to buy all the materials, and pay the high cost to carpenters, that you could not rebuild the same house for what you can get for it today. I do not know of any anywhere in my section of the country that would bring as much as it would cost to construct the same house. Therefore, building materials and the construction of new houses will absolutely control the sale price of old houses.

Mr. Buffett. Would you yield, Mr. Patman?

Mr. Patman. Well, I am going to give up the witness.

The Chairman. We will call the Committee in order.

Proceed, Mr. Patman.

Mr. Patman. You mentioned these sales. Was not the second, third, and fourth sale the principal cause of inflation during the last war, Mr. Eccles? That a real estate dealer would sell the home to the family, and the family would hardly get located until the dealer would go back to him and say, "Now, get your thousand dollars profit on this," and they would keep on pyramiding them that way. Was that not one of the main reasons and one of the principal causes for inflation in housing after the last war?

Mr. Eccles. I think it is a factor, and I think it is a factor now, and will continue to be a factor, and, therefore, the proposal, to the extent that it does stop the multiple sale of the same house, is of some value and effect.

Mr. Patman. You do not know of any better plan, do you, Mr. Eccles?

Mr. Eccles. Well, I think that capital gains tax might be a good plan.

Mr. Patman. Yes.

Mr. Eccles. In other words, I do not see any reason why we should discriminate against the homes in favor of stocks and business properties and farms. They are all capital assets.

Mr. Patman. That is right.

Mr. Eccles. And to the extent that you shut the door in one field, you may tend to stimulate it in another, and it would seem to me that the most practical way to get at the inflation of homes, as well as farms and business properties, and stocks, is to take out this speculative profit for the rise, that people who are in the high income brackets are buying for the rise, because, after holding for six months, they can then sell and pay only a 25 percent tax.

Mr. Patman. I realize that.

Mr. Eccles. We have left the door wide open in that field, and there have been simply millions and millions of dollars made by speculators. We are doing everything we can to encourage speculation in capital assets, and we have done absolutely nothing to stop the speculation.

Mr. Patman. Well, I do not agree with you. We are not doing everything we can. We are not doing anything to encourage it. We are just failing to act to stop it.

Mr. Eccles. Well, that is possibly a better way to put it. In other words, we have done nothing to stop inflation in capital assets.

Mr. Brown. Then, you say that if they put a ceiling on existing homes,

they ought to put it on stocks, farms, bonds, and have everything treated alike?

Mr. Eccles. Well, as a practical matter, you cannot get at it by putting a ceiling, it seems to me, on stocks or bonds, or farms. It would be even more difficult than it would be with homes. What I am saying is that they are all capital assets, and we should stop speculation by extending the holding period, and putting a special tax on.

The Chairman. Governor Eccles, would you be able to return this afternoon? There are several members who still have to interrogate you and you will not be able to conclude your testimony now.

Mr. Eccles. I will be able to return. I would like to get through today if I can.

The Chairman. Well, if you will return at 2 o'clock, that will be all right.

The Committee will adjourn until 2 o'clock.

(Whereupon, at 12 o'clock noon, the Committee adjourned, to reconvene at 2 o'clock p.m.)

AFTERNOON SESSION

(Whereupon, the Committee reconvened at 2 o'clock p.m., pursuant to the recess.)

The Chairman. The Committee will be in order.

Mr. Patman. Mr. Chairman, I just want to ask one or two short questions.

The Chairman. Mr. Patman.

Mr. Patman. Mr. Eccles, I do not want to press you for an answer on

these things, but it occurs to me that the Federal Reserve Board is really an agency of Congress, is it not? Is that the way you view it?

Mr. Eccles. That is the way I read the statute. We are required to make reports to you every year.

Mr. Patman. Well, being an agency of Congress, do you not think that we would be within our rights in insisting on you giving us the benefit of your views and suggestions, which would be helpful in answering the situation as it now exists or might exist in the future as regards inflation?

Mr. Eccles. Well, I think that it is certainly the right of Congress to request the Board, as its agent, for any information and advice that we are able to give.

Mr. Patman. I asked you about these reserve requirements this morning. I wonder if you would mind, in view of that premise, elaborating a little more fully on what the answer would be in regard to changing the reserve requirements of banks?

Mr. Eccles. The Board has used practically all of the power they have in increasing reserve requirements of the banks. In the case of the Central Reserve cities, namely, Chicago and New York, only, the Board does have authority to increase the reserve requirements against the demand deposits by 6 percent. That is the limit to which our present statutory authority would enable us to go.

Mr. Patman. Well, if we were to press you for your views on any stand you might have, do you have any views that you would care to express or would be willing to express, which you believe would be helpful if carried out by Congress in combatting inflation?

Mr. Eccles. Well, I feel that the Federal Reserve Board has practically no power to deal with the monetary aspect of inflation that it has not already used, with the exception of increasing interest rates to the extent that the Reserve system, or the Open Market Committee, we will say, permitted the short-term rate on Government securities to go up, that would be a deflationary factor. To the extent that the discount rate, which is now the regular discount rate, 1 percent, to the extent that that was further increased, the psychological effect of that, I have no doubt would be a deflationary factor.

It would be quite unsatisfactory, it seems to me, to meet this problem by what was considered the usual or the orthodox way of dealing with inflationary factors, which was through increasing the discount rate, raising rates. Now, the reason for that is that that would increase the cost of carrying the public debt, which is already very high, and it would likewise increase the earnings of the banking system, which are also high, and would be a very unsatisfactory way to deal with this problem, and I am sure that the Treasury would have considerable objection, as Congress and the public would, to increasing the interest burden on the public debt for the benefit of the banking system. Therefore, what could be used to deal with this problem, when the public debt was a very small part of the total debt, cannot be used today when the public debt is 2-1/4 times the entire private debt. It used to be 1/10, along in 1929, of the private debt, whereas today it is 2-1/2 times the private debt. So the means of dealing with the problem that would apply in a period when the public debt was small, cannot be used to deal with the problem when the public

debt is as great as it is.

Mr. Patman. In other words, you do not have the power to deal with the problem adequately?

Mr. Eccles. I do not think we have the power to deal with the problem at all--that is, I do not think that we have a power that we could be justified in using to deal with the problem.

Mr. Patman. Well, can you state any power or powers which, if given you by Congress, you could exercise, which would be helpful in this emergency?

Mr. Eccles. I think that legislation--and it would take legislation--in order to give to the Federal Reserve Board adequate powers to deal with the situation. There are various ways, I think, in which the matter can be dealt with.

I should like to cover that matter inasmuch as it is of such great importance, and could be misconstrued or misinterpreted. I should like to see that a matter of that sort be covered in a report or in a special hearing set aside for that purpose, when I might have adequate time to prepare a statement.

Mr. Patman. Would that require say, a week or ten days, Mr. Eccles? The reason I ask if you can do it within that time, or within say two weeks, I would like to ask for consent that you get up your statement and file it in this particular record. Then, if any members of the Committee wish to interrogate you about it, they could ask you to come up for that purpose. Would you rather do it that way?

Mr. Eccles. Well, this is a matter that the entire Open Market Committee

and the Federal Reserve Board are as interested in as I am, and I would think that a report, such as you have indicated as being desirable, should be an expression of the views of those in the Reserve System, or responsible for the policy.

Mr. Patman. Yes, sir.

Mr. Eccles. I would think that that should come up here as a report of the Board, as a part of the report which we send to Congress, or as a special report. We have sent special reports out. If it comes in that way, I imagine the report to Congress would be referred to this Committee and could be put either in this record or could be used as a basis for legislation or as a basis for a hearing in connection with the consideration or legislation.

Mr. Patman. Well, I want to make a request that you prepare a report to the Chairman of this Committee, to go in the hearings on this Bill. If you will and if that is not unreasonable. Do you not think that would be in order and should be prepared, Mr. Chairman?

The Chairman. If Mr. Eccles wishes to do it, yes.

Mr. Eccles. Do you mean to have the Board do that?

Mr. Patman. Any way you want to do it. Either yourself, after consultation with the Board, or the Open Market Committee, or as an expression from the Board and the Open Market Committee.

Mr. Eccles. Well, I will be very glad to report to the Board and the Committee this request, and I should think they would be glad to respond.

Mr. Patman. To embody any and all the suggestions which you have to make which would be helpful in dealing with the present emergency, and

that is asking for legislation, if necessary, and what kind. That is all, Mr. Chairman.

The Chairman. Mr. Wolcott.

Mr. Wolcott. I have no questions at this time.

The Chairman. Mr. Folger.

Mr. Folger. Mr. Eccles, what you have just been talking about would hardly be apropos of this legislation that we are investigating now, would it?

Mr. Eccles. Well, certainly I would not feel that it should be tied in with it or made any part of it in any way. It is my opinion that this legislation should be extended without amendments, because if the door is open to amendments, it would likely be a little difficult to get the legislation passed in time. I would think that this matter of dealing with the monetary questions which Congressman Patman raises, I would think, is something which should be covered by special legislation, because it certainly would be a very controversial question.

The Chairman. I do not think it would be essential to have your report in these hearings.

Mr. Patman. Well, Mr. Chairman, if he will prepare it, I presume you would be willing to give the members an opportunity to hear Mr. Eccles on it.

The Chairman. This Committee is open for Mr. Eccles any time he wishes to come before us. But I do not think it should be incorporated in this Bill.

Mr. Eccles. No. It would seem to me, as I suggested to the Congressman, that it might be well if the Board and the Open Market Committee are

willing to make a report on this question to the Congress, then, this Committee could consider such a report and could hold hearings in connection with the report, as they have done in the past, with reference to recommendations.

The Chairman. We will be very glad to hear you.

Mr. Gamble. But it would have no relation to this Bill as far as legislation is concerned.

Mr. Patman. That is right. It is not contemplated that it should have.

Mr. Folger. Mr. Eccles, on the matter of control of prices, the necessity for it comes about, as we see every day, in large measure from the fact that our purchasing power is so great and the things to buy are so few, and we are in a position where we have the necessity of price control; is that not right?

Mr. Eccles. That is correct.

Mr. Folger. Are there not other considerations that should enter into this, such as adequate tax legislation aimed at balancing the budget, and not forgiving too many taxes by reductions such as we had in the Rural Plan and others?

Mr. Eccles. The statement that I have prepared this morning, and upon which I was interrogated, brought out the fact that this legislation is not dealing with basic causes. It is merely dealing with the effects, and that we must deal with the causes as well as with the effects, and the causes were recognized as being one of inadequate production, which is of prime importance--that is, to get greater production--and the other causes

were the unbalanced budget and the need of balancing the budget and if possible getting a surplus, and maintaining taxes as they were. The third one was stopping monetization of the public debt through the banks further increasing their purchasing of Government securities.

A fourth one was dealing with the inflation in capital assets, such as stocks, homes, farms, and business properties, by a capital gains tax applying to future purchases. Those were the four factors--I meant a special capital gains tax and extension of the holding period--those were the four factors that seem to me to be necessary considerations in connection with this price control legislation.

Mr. Folger. What I was intending to follow that up with was this: that you might, by the neglect of these other factors, place on price control too great a burden in the matter of doing what we call stopping inflation.

Mr. Eccles. There is no question but what price control just could not possibly succeed if we do not get increased production on a very large scale, and if we do not stop increasing as rapidly as we have been doing, or if we do not stop increasing altogether, the supply of money.

In the months of November and December our banking system created close to 11 billions of dollars of new money. They increased their holdings of Government securities better than 7 billion dollars.

Mr. Smith. Which month was that?

Mr. Eccles. In the months of November and December. And they increased, during the Victory Bond Drive, they increased their loans on Government securities--which is just the same as buying them directly,

because that credit creates money--

Mr. Gamble. Who did that, Mr. Eccles? Pardon me.

Mr. Eccles. Our commercial banking system--close to something like three billion dollars, and they made other loans and investments of about a billion dollars. Those are just rough figures. Now, to get some idea of what that means in an inflationary picture, 11 billion dollars is fully 40 percent of the total demand deposits that we had in 1929, and it is more than 40 percent of what we had in 1933, 1934, and 1935. So we created in two months, in new money, a volume of 11 billion dollars. That is pretty fantastic.

Now, I do not see, of course, how there is any likelihood of any such expansion even approaching that in the future, because that was due to the Victory Drive, and in order to subscribe to the new issues, the short-term securities, securities that were eligible to the banks, were sold to the banking system by the corporations, individuals, insurance companies, and others, and they, in turn, subscribed very heavily for the Government two and a halfs. Those two and a halfs and two and a quarters were subscribed in the amount of better than 11 billion dollars. The result is the Treasury got more than twice as much money in this drive as the quota it had fixed. Those 2-1/2's are now selling at a premium of over 5 percent. There is already a premium on those 2-1/4's and 2-1/2's of close to 500 million dollars, from which the Government gets no benefit.

Mr. Folger. Is there any method or machinery that we might employ for encouraging individual ownership of Government securities? To have people buy them and hold them instead of having money in the bank? They have to have money to buy them with.

Mr. Eccles. Well, of course, I think an effort is being made to get the people to hold them. The E, F, and G bonds, the non-market bonds, are the kind of securities that should be offered to the public, and not the market bonds, which they can speculate in.

The E, F, and G bonds are now available for public subscription, and I understand the public are buying considerably more of the E, F, and G bonds than are being cashed in, of the same E, F, and G bonds. They are increasing their holdings on balance. It is true that there are a great many more Government bonds that could be bought, with the deposits that are being held idle today. There is a lot of money that is not being used, which, of course, could be invested in Government securities. If that should happen, it would mean that the Government bonds held by the banks, the banks, would have to sell them, and the individuals and corporations would buy them. That would reduce the deposits, on the one hand, and reduce the Government bond holdings, on the other. That would be reversing the process that has been going on during the war, which is a desirable thing to bring about.

Mr. Folger. Maybe that is the psychology we ought to get the people to understand, that this surplus money that they are not able to spend ought to be invested in these bonds which are salable to the public.

Mr. Eccles. Well, if we can assure them there is going to be no inflation, and that we can hold prices, that is the first essential to get people to invest money in Government bonds instead of real estate and stocks.

Mr. Folger. Would that not help us in holding down inflation? That is, money which we call "hot" money would be invested in bonds and not in

high priced commodities or real estate or other things of that sort?

Mr. Eccles. It would be very helpful, of course. If we had been able to do all of the war financing outside of the banks, that would have been still better.

Mr. Folger. That is all.

The Chairman. Mr. Gamble.

Mr. Gamble. Governor Eccles, in your statement, you talk about getting commercial banks to sell part of their bonds, and get those bought by the public. It is a matter of persuasion, largely, is it not?

Mr. Eccles. I do not think you are going to persuade them.

Mr. Gamble. Well, I have been wondering if it would not act as a little persuasion if we could stop our deficit financing and get out of the red. You speak here of balancing the budget. It seems to me that we are going to be in the red 4 billion dollars as contemplated under the budget program. I very much wish that Congress could save that 4 billion dollars, so that we could just be on an even keel. I think that in itself would hearten the American people and they would be more willing perhaps to buy bonds in peacetime than they have been.

Mr. Eccles. There is no question but what a balanced budget would be helpful in preventing inflationary development, and would tend to give the public increasing confidence in the public debt.

Of course, although there is in the budget report a deficit contemplated for the next fiscal year, there will be a reduction in the public debt due to the fact that more money was raised in the Victory Loan Drive than was necessary or contemplated. That leaves the Treasury balances, of course,

abnormally large, and some of those balances, without question, will be used to pay off some of the maturing debt, so that the volume of outstanding Government obligations, over the next year, should decline, I would think, in the neighborhood of seven or eight or nine or ten billion dollars, depending upon two factors: first, the amount of Government expenditures, and, secondly, the amount of tax revenue.

As to what that will be in the next fiscal year, will depend a good deal to the extent Congress further reduces taxes, or to the extent that Congress further appropriates money. But it would appear at this time that there will be some substantial reduction in the public debt.

Mr. Gamble. Some people say that that reduction that is contemplated is more or less of a bookkeeping transaction, but it seems to me you have got the money, and you have paid off your bonds, so you have reduced your debt. Secondly, by doing that, using that money for that purpose, it cannot be used for something else.

Mr. Eccles. Well, it is a bookkeeping transaction, but it is the kind of a bookkeeping transaction that a corporation or an individual has when they build up a cash balance, and they have a debt, and they use their balance to pay the debt. The Treasury has a balance here which it got through borrowing beyond what they need, and now they are using it to pay off some maturing debts.

Mr. Gamble. I would like to see it used for that purpose before somebody gets an idea of how to spend 4 billion dollars, and says, "There is the money."

Mr. Eccles. Well, I agree with you fully.

Mr. Gamble. Do you consider when FHA's capacity is increased, with regard to the housing bill, for instance, that that is inflationary? Some people seem to think it is and others think it is not. It provides a means by which some people can spend their money to build a house, they say.

Mr. Eccles. Well, it is only inflationary to the extent that those Federal Housing Administration mortgages are financed through the banks. What I think we all favor, of course, is the banking system making private loans--such as Federal Housing Administration mortgage loans and corporate and other loans--and reducing the amount of Government loans. In other words, if the banks could make a few billion dollars of Federal Housing Administration and other private loans, and reduce their holding of Government securities by that amount, it would be a desirable thing, and the banks would be coming more into the function of private lending institutions than has been the case during the war period.

The Federal Housing Administration mortgage lending will, of course, be offset by new houses, so that there is an expenditure that is inflationary, we might say, on the one side, but it is also deflationary to the extent that it gets production of more houses. The only way in which you can overcome finally the inflationary pressure in the real estate field, in the housing field, is to get enough houses, and I do not object to the kind of credit that produces more goods, and more services, where there is a short supply.

Mr. Gamble. And housing is one of thoseitems that you refer to. You said that we will not be able to produce enough automobiles in the next year. I do not think we will be able to produce enough houses in the next four or five years.

Mr. Eccles. Building materials are going to be in short supply for some time, of course. They must be controlled.

The Chairman. Mr. Hays.

Mr. Hays. No questions.

The Chairman. Dr. Smith.

Mr. Smith. Mr. Eccles, I appreciate very much your bringing this inflationary problem out into the open. It is encouraging.

Mr. Eccles. Well, this is not the first time, Dr. Smith.

Mr. Smith. No, that is very true, Mr. Eccles, and I have always appreciated you. You have been one Government official who has always been very brave in this matter. Mr. Crawford left a question here for me to ask you: You spoke about raising the reserve requirements, and at the same time having the banks make an effort to dispose of their Government securities and holdings to the public. Mr. Crawford raised the question as to whether those two proposals or procedures might not be in conflict with each other.

Mr. Eccles. Will you ask that question again? I did not get the significance of it.

Mr. Smith. Well, if you raise the reserve requirements, but at the same time you put in motion a policy urging the banks to dispose of their Government holdings to the public, do not those two conflict with each other? In other words, you would be taking funds out of the banks, commercial banks, and placing them in the Federal Reserve Banks, which would reduce the cash holdings of your banks, and, therefore, there would be less money available. I think that is his question, for the purchase of securities.

Mr. Eccles. No, it would work exactly in the opposite. If reserve requirements of the banks were increased--and, by the way, as I stated earlier, there is no authority in the Reserve Board to increase reserve requirements, so the question is purely academic--

Mr. Smith. Yes, I understand that.

Mr. Eccles.--the banks, to meet the increased reserve requirements, would sell Government securities, because they would have to get the cash that is in the Government securities to meet the increased reserve balances with the Federal Reserve banks.

Now, if the public bought the securities, they would merely draw their money out of one bank, and they would buy the security and it goes right back into the same bank or into another bank. It does not in any way reduce the individual's deposits in the bank. The individual or the corporation are the only ones who can reduce their account. They reduce that account by drawing it out, and if they buy something from the bank--if they draw the money out from the bank, and buy something--then, the deposit goes down on one side, which is a liability, and the Government bond, on the other side, goes down so it is a complete offset to the extent that the individual draws the deposits out of the banks and buys Government securities held by the banks. One offsets the other.

Mr. Smith. In other words, the newly created credit established by the process of financing the bond in the first place by the Treasury--

Mr. Eccles. It is just reversed.

Mr. Smith. That credit, when the non-bank holder buys a bond, the amount of that newly bank created credit is reduced by that amount; is that not so?

Mr. Eccles. That is right.

Mr. Smith. Now, I am interested, Mr. Eccles, particularly in your urging that the Federal budget be balanced. When did the Treasury first begin to finance Government obligations through the banking system? They started that during World War I, did they not?

Mr. Eccles. They did it in World War I, but in a different manner. At that time they had no open market operation, Open Market Committee. They knew nothing about that mechanism. In World War I, the banks loaned to individuals and corporations, and the individuals and corporations bought the bonds, by paying maybe 10 percent down, and on an installment basis, they purchased the bonds from the banks. That is, they borrowed the money from the banks with which to buy the bonds. So the banks created the money for the individuals and the corporations to buy the bonds, rather than buy them directly as they have during this period. And they, in turn, borrowed the money from the Reserve Banks on a rediscount, or bills-payable basis.

Mr. Smith. So that if one bought a bond from a bank, and borrowed the money to pay for the bond, by the amount that one actually paid on the bond, there would be a reduction in the inflationary potential of the bond; is that correct?

Mr. Eccles. To the extent the bonds were paid for, that is correct.

Mr. Smith. Well, now, I notice--and I got this from your agency--at the close of the war, the commercial banks held roundly 5 billion dollars in Government securities, so all of those securities, then, as I understand it, had been purchased by individuals and were held by the banks, the

nonbank holders having borrowed money to purchase those bonds. All of that money, that whole figure, represents bonds of that character; is that correct?

Mr. Eccles. Oh, I could not say. I do not remember the history of it, except in a very hazy manner. I do not remember the figures. I think, however, that every effort was made to do the financing, in the last war, by getting individuals to buy, and to the extent they did not have the cash to buy, by inducing them to use bank credit. And then, to the extent that they wanted to pay off their loan, they sold their bonds and the banks bought the bonds in the market, as they have bought them in the market during this war. There have been no Government bonds, or very few, offered directly to the banks. I think there were some maybe in '42. But in 1943, 1944, and 1945, I do not believe there was any direct offering to the banks, during any of the drives that were made.

The banks acquired their Government securities as secondary holders, through purchasing them in the market, from the public who subscribed and sold the securities in the market. Now, that is true with the exception of Treasury Bills. The banks can buy directly Treasury Bills. That is a 3/8 bill.

The Chairman. Do you have the figure as to the amount that the banks bought, of Treasury Bills?

Mr. Eccles. Yes; there is a total outstanding of Treasury Bills of approximately 17 billion dollars. And of that amount the Federal Reserve holds about 13 billion dollars. The banks only hold about 4 billion dollars of those Treasury bills.

Mr. Smith. And the remainder of the bonds held by the banks now were actually acquired by them from non-bank holders?

Mr. Eccles. Well, they have acquired them since the Treasury began its drive--

Mr. Smith. In 1941?

Mr. Eccles. 1942.

Mr. Smith. Now, what amount of newly created bank credit is in existence at the present time? Can you tell me? I have a figure here from the Treasury as of December 31, 1945, which shows a total of 114 billion dollars held by the commercial banks and the Federal Reserve Bank. Does that figure check with you?

Mr. Eccles. What date is that?

Mr. Smith. December 31, 1945.

Mr. Eccles. That is a total of what, you say?

Mr. Smith. A total of Government obligations held by the commercial banks and the Federal Reserve Bank.

Mr. Eccles. Our figure is less than that--considerably.

Mr. Brown. You stated 95 billion dollars this morning.

Mr. Eccles. Yes, 114. That may include savings banks.

Mr. Smith. This says commercial banks and Federal Reserve Banks.

Mr. Eccles. The Federal Reserve has a total of around 23 billion dollars, and the commercial banks around 72 billion dollars.

Mr. Smith. I have the figure for commercial banks, 90 billion dollars from the Treasury, and 24 billion dollars for the Federal Reserve Banks.

Mr. Eccles. That is correct. The 95 billion dollar figure that I gave you was the increase in holdings from 1940. You see, I was giving the growth in deposits from 1940. These figures would be the 95 billion dollars plus the holdings of the Federal Reserve and the commercial bank, as of 1940, and I think those figures are about right.

The Chairman. I do not think the stenographer understood you this morning. You said 95 billion dollars.

Mr. Eccles. Increase since 1940. It was in my statement. I was giving the growth, and the growth was 95 billion dollars since 1940. This is the total. So you would have to take what was held in 1940, plus the 95 billion dollars.

Mr. Smith. This 114 billion dollars represents, then, the newly created credit in the commercial banks and in the Federal Reserve Banks at the present time; is that correct?

Mr. Eccles. What is that you say?

Mr. Smith. This figure of 114 billion dollars represents the newly created bank credit?

Mr. Eccles. No, not newly created.

Mr. Smith. Why not?

Mr. Eccles. Because there was twenty-some-odd billion dollars of it in existence in 1940.

Mr. Smith. Yes. Well, I meant to include what was created before 1940, because the character and nature of it is the same since 1940 as it was before that; is that not correct?

Mr. Eccles. Yes, but you asked me if this 114 billion dollars did

not represent the newly created credit.

Mr. Smith. What I meant by newly created credit was to include all of the credit created in that manner by the banking system for the total time this process of financing has been carried on.

Mr. Eccles. This 114 billion dollars represents the total amount of bank credit that has been created by the commercial banking system, and the Federal Reserve System, over the period--I do not know how long it is,--since they have been purchasing Government securities. It would go over a good many years. Even in the 20's there were holdings of Government securities by the banking system, and this amount would be part of the amount that existed in the 20's or during the last war.

Mr. Smith. Under what authority do the banks purchase these Government securities when they purchase them directly from the Government?

Mr. Eccles. You mean the commercial banks?

Mr. Smith. Yes. I know as to the Federal Reserve Banks we passed some acts since this war began, but I am thinking about the commercial banks in particular. Could you give me the statutes, or cite to me the statutes that authorize the Treasury, or permit the banks to purchase Government securities from the Government?

Mr. Eccles. I do not know that there is any special statute. The Treasury offers their securities, and they have the authority to determine who they will accept subscriptions from, and in their drives they accepted subscriptions only from non-bank investors. They excluded the banks. Now, they could have included them had they chosen to under the authority that the Treasury has, to the extent they excluded the banks from buying

directly from the Treasury, subscribing for their various offerings, there was nothing to prevent the dealers and the public from subscribing for securities and, in turn, selling them to the banks at a profit to the subscribers, and as a result of that operation, it created a lot of speculation in Government securities.

Mr. Smith. The reason I am asking this question is because I am greatly confused about it. I had the Law Library of Congress look this up for me, and they cited one or two statutes, under which this financing is done, and then I telephoned to the Chief Counsel of the Treasury, or his assistant, I have forgotten which, and asked him about it, and he replied that there was no specific statute providing for it. But after I had cited to him these two that had been cited to me by the Law Library of Congress, he seemed to change his mind somewhat and pointed out three or four additional statutes which he thought had to do with this matter. I was wondering whether you would care to look that up for me and put in the record a statement showing just what that citation is. Would you care to do that?

Mr. Eccles. Well, now, I would like to have our lawyers, since it is purely a legal question, and I am not a lawyer, go into it, and if you could give me the exact question, I will be very glad to have our legal division answer it if they can.

Mr. Smith. The exact question is this: Do the banks have legal authority, or are there any particular acts, which especially authorize banks to acquire Government securities of any kind, commercial banks, that is, directly from the United States Treasury. That is the question.

And, if so, what are those statutes? I would like to have them cited.

Now, Mr. Eccles, I was not here this morning, and apparently from some of the questions that I heard after I came here and some of your statements, I suppose you stated the total amount of liquid assets that are in the possession of our people at the present time.

Mr. Eccles. The possession of whom?

Mr. Smith. The total amount of assets that are now in existence or in the possession of our people. Liquid assets.

Mr. Eccles. Well, I stated what I termed potential inflation which represented the bank deposits, demand deposits, savings deposits, currency, and Government securities.

Mr. Smith. You mean marketable Government securities?

Mr. Eccles. No. All Government securities are marketable in that if they are E, F, and G bonds, they can be turned in to the Treasury any day. They are cashable on demand.

Mr. Smith. Well, are the Government bonds held by Federal agencies marketable?

Mr. Eccles. Well, I was going to say that I excluded from this figure all of the securities, Government bonds, held by the Federal Reserve Banks, the commercial banks, the savings banks, the insurance companies, and the Government agencies.

Mr. Smith. You mean you excluded those?

Mr. Eccles. I excluded those in determining the potential inflation.

Mr. Smith. Would that be the same as the liquid assets?

Mr. Eccles. Well, what that left. That left the cash; that left

the bank deposits, and the currency, and the Government securities in the hands of individuals and corporations. That is where the potential inflation is. There is no potential inflation in the Government securities held by an insurance company or a commercial bank or a Federal Reserve Bank because they cannot sell those securities and go out and buy real estate or buy stocks or buy commodities. There is no way in which they can convert those into things, such as individuals or corporations.

Mr. Smith. What was your figure, then, for liquid assets?

Mr. Eccles. I do not recall it now. It is in my prepared statement which I gave here.

Mr. Smith. Well, if it is in there, that is perfectly all right.

Mr. Eccles. Yes, it is in that statement, Dr. Smith.

Mr. Smith. Could you tell me, Mr. Eccles --

Mr. Crawford. Will you yield, Mr. Smith?

Mr. Smith. I yield to Mr. Crawford.

Mr. Eccles. According to my statement, that figure is about 275 billion dollars, Dr. Smith. It is about five times the amount that existed prior to the war, in 1940.

Mr. Smith. How much more is it, Mr. Eccles, than we had following the conclusion of World War I? Can you tell me that?

Mr. Eccles. No, I cannot.

Mr. Smith. Would you care to have that looked up and inserted in the record?

Mr. Eccles. All right.

(The document above referred to is as follows:)

Mr. Smith. I yield.

Mr. Crawford. Mr. Eccles, there, of course, would be no conflict whatsoever between the Board raising the Reserve requirements and having the banks sell bonds to the public in order to acquire the funds with which to deposit, in the Reserve Banks, to meet the increased requirements, there would be on conflict there. Now, what I think would be appropriate for us to ask on this particular study would be this: Would the Board require any further statutory authority to increase those requirements above what they are at the present time?

Mr. Eccles. That question was asked me, I think, by Congressman Folger, and I pointed out that we have used all of the authority that we have in the statute, with the exception of the authority to increase the Reserve requirements against demand deposits on Central Reserve cities from 20 percent to 26 percent. That is the only authority that is left us.

Mr. Crawford. If we wanted to materially assist the Board in moving bonds from bank portfolios into the hands of the public, we could well do so by giving you that additional authority, could we not?

Mr. Eccles. That would require the banks to sell some securities all right. I do not know how fast the public would take them. It would be up to the Federal Reserve to support that market, of course, until such time as they were absorbed.

Mr. Crawford. Yes.

Mr. Eccles. In other words, the Federal Reserve is in a position to provide for an orderly transition and maintain stability in the market

while that process was going on.

Mr. Smith. Right in that connection, Mr. Eccles, when the bank sells its holdings of Government securities to the public, it converts illiquid assets into liquid assets; is that not true?

Mr. Eccles. Well, no. When the banking system sells the bonds to the public, the banking system, as a whole -- you see, if you had one bank, it would be easy to follow, but you have 14,000 -- but as the banks, as a whole, sell Government securities in the market, the deposits held by the purchasers of Government securities are withdrawn.

Mr. Smith. Yes, I understand that.

Mr. Eccles. So that one offsets the other.

Mr. Smith. That was not the question I asked. You might have an equal amount of inflation, but my question was that when a bank sells this bond to the public, to me, for example, if I go to the bank to buy a bond, I now have something which I cannot convert into things; is that not true?

Mr. Eccles. That is right, as long as you hold that bond, your money is tied up in that bond, and people are much less likely to use bonds than currency or bank deposits.

Mr. Smith. Well, I suppose you read the article by Benjamin M. Anderson, where he recommended that the interest rate be raised on bonds so as to make them attractive for the public to acquire them from the banks? From your statements here today, it seems to me that you would be in favor of raising that rate, or maybe I am mistaken.

Mr. Eccles. Yes, you are. I certainly would not be in favor of raising the rate that the Treasury is now paying. The Treasury is paying

2-1/2 percent on its market bonds, and those are non-eligible to banks until they get within 10 years of maturity.

Mr. Smith. Just what do you mean by that statement?

Mr. Eccles. Well, I mean these 2-1/2 percent bonds, the bank cannot own them or buy them until they get within 10 years of maturity. They are 25-year bonds -- maybe 22's or 27's, callable at 22 or 23 -- and when they get within ten years of maturity, banks can buy them.

I think the rates that the Treasury pays on its E, F, and G bonds are quite adequate.

Mr. Smith. Attractive enough so that they will be held by the public?

Mr. Eccles. The public do hold them in a very large amount and are buying them today.

Mr. Smith. Of course, you cannot tell what the psychology is going to be in the future, I realize that.

Mr. Eccles. What is it?

Mr. Smith. I say we cannot tell what the psychology is going to be in the future but --

Mr. Eccles. I do not think you can raise the long-term rate above what the Treasury is now paying. The complaint that is being made today is not a complaint to the effect that the rate the Treasury is paying is not high enough; the complaint is that the rate that the Treasury is paying is not being maintained -- that that rate is rapidly falling. For instance, the bonds that were put out in the November and December drives, the 2-1/2 percent bonds, are selling today at more than 105. They are selling on a yield basis of not 2-1/2, which is what the Treasury is paying, but they

are selling on a yield basis of 2.2.

Mr. Smith. Do you think, then, that Dr. Anderson was wrong in his views?

Mr. Eccles. Well, I would be very much surprised if Dr. Anderson and I agreed, because he and I have never agreed on anything, as far as I can remember, in about ten years.

Mr. Smith. Just a few more questions, Mr. Eccles. You made the statement that foreigners are holding some of our currency, Federal Reserve Notes, I take it. Can those people convert their Federal Reserve Notes into gold? Can they buy gold with those notes?

Mr. Eccles. I do not know where. They cannot buy it in this country.

Mr. Smith. Why?

Mr. Eccles. Because gold is not in circulation.

Mr. Smith. Well, did you mean foreigners living in this country -- or --

Mr. Eccles. I do not care where they are living. Anybody that owns Federal Reserve Notes cannot convert it into gold, whether they are a foreigner or a citizen.

Mr. Smith. Why?

Mr. Eccles. Because the law does not permit it. It prohibits it.

Mr. Smith. What specific law?

Mr. Eccles. Oh, I do not know as to that. The Federal Reserve, as a matter of fact, does not own any gold. The gold was all taken out by the Gold Act that was passed by Congress, which turned all the gold over to the Treasury, and that gold is still held by the Treasury. Any gold that comes

into the Federal Reserve must be immediately turned over to the Treasury, and all the Federal Reserve gets are gold receipts, or gold certificates.

Mr. Smith. So there is no danger at all of foreigners who hold these notes converting them into gold?

Mr. Eccles. There is no danger of any individual converting their holdings into gold. There is this possibility: that is, a foreign central bank, or as a foreign central government, desires to get gold, they can get gold, for their dollar balances.

Mr. Smith. That is exactly the point that I am coming to. These notes, held by foreigners, can find their way into these central banks, and in that manner, that round-about manner, become converted into American gold; is that not true?

Mr. Eccles. That is correct. But if we take a Frenchman, for instance, he has American dollars. He turns those dollars into a French bank and he gets francs for dollars. Those dollars would go into the Bank of France. The Bank of France would get credit in the Federal Reserve Bank, so that the Bank of France would, in that situation, have dollars to their credit at the Federal Reserve Bank of New York, let us say, or any other Federal Reserve Bank they sent them to.

Now, to the extent that they want those dollars converted into gold, either for export or earmark, they can request it, and up to date it has been granted, with one or two exceptions.

Mr. Smith. Now, Mr. Eccles, you recommend balancing the budget, and we certainly cannot continue to pay subsidies and expect to balance the budget; is that not correct?

Mr. Eccles. Well, it depends on how large the subsidies are.

Mr. Smith. Well, we will be asked to vote an amendment providing 600 million dollars of subsidies for the housing program, the Wyatt Housing Program. Where is the Government going to get that money, except through bank financing?

Mr. Eccles. Of course, the Government has already got the balances. It would mean that to the extent that the Congress appropriates more money, the Government would be able to pay off less of its outstanding debt, because there will not be any more Government financing required. It will merely mean that the Treasury balances at the present time would be used for a housing subsidy to the extent of 600 million dollars instead of paying 600 million dollars on the public debt.

Mr. Smith. Do you think, then, that President Truman's message to Congress, his budget message, sent along with his message on the state of the Union, is correct?

Mr. Eccles. Well, I couldn't say. I am not an authority on the budget. I would assume that it was correct. I cannot imagine the Budget Bureau sending up a budget that would not be factual.

Mr. Smith. I have gone over that pretty carefully, and when I saw, for example, that, included in one of his tables, something like 48 billion dollars of income by the Government, which included the income derived through the financing of Government obligations through the banks, I could not help but feel that there was something quite unbalanced about his balanced budget. I do not believe it is quite correct to say that Government printing press

money is actual income, and, of course, you and I do not agree but --

Mr. Eccles. Well, it is a question of definition. Of course, in the broad sense, whether the Government gets its money from taxation or borrowing, it is all income. The income can be divided, of course, into its sources of income, just as expenditures are all expenditures, even though some of them may be money that the Government loans, it is still classed as an expenditure.

Mr. Smith. Well, maybe we would have a better understanding of it if you would refer to it as income derived from production, and income derived by the financing of Government obligations through the banks.

Mr. Eccles. The taxes, of course, would be income. The Government derives practically no income from production, because it is not engaged in the business of production. The Government could not classify any of its income as income from production.

Mr. Smith. Well, Mr. Eccles, I think you probably misunderstand me a little bit there. I mean that the taxes themselves were created by production, and were an expression of production. They would not exist if people had not produced. That is my point.

Mr. Eccles. There are a lot of taxes collected that do not come from production. There are a lot of taxes collected that come from speculation. People make money without producing a thing. Look at your stock market trading and other operations. People make a profit and they do not always render a service, and they do not always produce something.

Mr. Smith. Well, of course, I take that in this way: that is more or less of an abnormal situation. It is not really a part of the question that I asked. Now, just one more question, Mr. Eccles. We are talking in quite

a lively manner and rather loosely of bringing production up to the point where it will balance with the volume commonly called purchasing power. I think "purchasing powerless" would be a better expression. But let us call it purchasing power since that is the common way of putting it. I would like to know whether you have any idea as to the amount or volume that must be produced to bring about that balance?

Mr. Eccles. No, I have no idea as to the figures.

Mr. Smith. Have you ever seen any study of it?

Mr. Eccles. No, I do not know that I have.

Mr. Smith. No one has risked projecting any ideas on that point?

Mr. Eccles. I think that we can feel reasonably safe in saying that, as a result of our war experience, if we add to the civilian production that we were able to produce during the war, with nearly half of our production capacity producing goods that were not available for civilian use, and with half of our labor either in the armed services or engaged in the production of war goods, that to get all of that labor effort and all of those productive facilities engaged in the production of civilian goods, that the supply of goods, with some exceptions, of course -- and I pointed out those exceptions this morning -- the supply of goods would be sufficient to --

Mr. Smith. Bring it into balance.

Mr. Eccles. -- meet a demand at least to the point where people would not follow prices up. If people felt that production was on an expanding scale, that they had a chance to purchase goods even at a current price, or at a lesser price by waiting they would not be inclined to follow that market

price for goods going up. And that is what I say: I think that a year's extension of this legislation, given full production, that there would be surpluses of a good many goods, and I think that in most categories, with the exception of the construction field, automobiles, there would be sufficient production so as to take off the inflationary pressures.

Mr. Smith. Mr. Eccles, what is the history of those situations? Can you point to me any period in history when production was rising, the demand was satisfied to the extent that it would stop the increase in prices? Do you know of an instance, at any time in our history?

Mr. Eccles. Well, I think that it is always true, that when you get a supply of goods in excess of the demand for goods, prices do not continue to rise. They usually fall.

Mr. Smith. Was there a shortage of goods in the 20's?

Mr. Eccles. There was no rise in prices in the 20's. Prices fell from an index figure of 105 in 1924 to 95 in 1929.

Mr. Smith. That is true, but how was the index compared with 1914?

Mr. Eccles. Well, you had a higher price. You never went back to your 1914 level of prices.

Mr. Smith. Let us go a step further with that. If we are going to use the war formula for peacetime production -- if we are going to use the formula we used for producing war goods -- what part of that formula are we going to use? All of it? Or just part of it? In other words, are we going to continue deficit financing? That is, part of the formula we used to carry on the war.

Mr. Eccles. Well, I certainly do not thing that there would be any need of undertaking to maintain price controls unless we are going to get a great increase in production, and unless we are going to stop creating money through deficit financing. In other words, while we are dealing with the effects of inflation, through price control, we must also undertake to deal with the causes of inflation.

Mr. Smith. The inflation itself?

Mr. Eccles. That is right, we must deal with the causes that have created the inflation.

Mr. Smith. That is a fine statement.

Mr. Eccles. And if we do not, of course, we cannot lick inflation.

Mr. Smith. The reason I bring this up is because tomorrow we begin the debate on the first attempt to put into operation the war formula of production in peacetime. The Patman Housing Bill represents that attempt, and the Patman Housing Bill had subsidies in it. That section was stricken by the Committee but an amendment will be offered to put the subsidies back. I have gone over Mr. Wyatt's whole housing program, and if he is going to -- as I understand him, he even wants to make the Government a market for these homes -- I am just wondering whether we are not pretty much confused in this whole matter of bringing production up in peacetime because we could bring it up in wartime.

Mr. Eccles. Well, a subsidy is not always inflationary. A subsidy may be deflationary in effect. I think subsidies can often be used to a

very beneficial effect in preventing inflation.

Mr. Smith. Preventing the effects, you mean, of inflation?

Mr. Eccles. No. In preventing inflation.

Mr. Smith. Well, suppose that --

Mr. Eccles. But the way you prevent inflation is to get production, and if certain subsidies are necessary in order to get production, it may well be that the subsidy is very much less inflationary than the production is deflationary.

Mr. Smith. But if the money for the subsidy is raised by deficit financing, or Government printing press money, you certainly do not believe there is any way in which you can possibly say that ultimately the effect will have to be deleterious?

Mr. Eccles. Well, as I say, it depends on the extent of the subsidy. I have in mind, for instance, this: during the war, we needed all the copper we could get and still do need it. There are certain very high cost producers which, at the ceiling price of copper, could not afford to produce copper and would not produce copper. Now, to raise the ceiling price enough to induce the high cost producer to produce copper, would give an abnormal profit to the great bulk of low cost producers. Therefore, it was very much to the public interest to keep the price of copper, which I think was 12 cents, and in order to get the extra 10 per cent of high cost production, to give them a subsidy on that extra 10 or 15 per cent of copper of three or four cents necessary to keep them in

production. That was very much cheaper than raising the price of all copper produced sufficiently high to keep the high cost producer in production.

Now, I can see similar situations, in which you may find that, during this period of shortage of supply, that you need to keep the high cost producer in production, and it may be cheaper to give him a subsidy--cheaper for the public, that is, to give him a subsidy, than to raise the price to all producers, and the high cost producer represents a small part of the total production.

In this housing situation--I am not thoroughly familiar with the details of Mr. Wyatt's proposal--it may very well be that to overcome the inflation in the housing field, and to get mass production of housing, it may be that a certain amount of Government help or subsidy is necessary in order to get mass production in time to break the inflation in the housing field. That, of course, is a debatable question, because I do not know enough about the facts.

Mr. Smith. Well, Mr. Eccles, what about the principles? After the Revolutionary War was concluded--the Revolutionary War was financed largely by Government printing press money. But the moment the war ended, the statesmen of this country did away with bills of credit, did away with Government printing press money. They did not set up programs here and there and say, "Now, we can still print bills of credit to take care of these particular costs." They did away with the whole business, and I am wondering if there was a justification for paying subsidies to those high cost producers during the wartime, whether there is any possible

justification for it at the present time. What I am afraid of, Mr. Eccles, is this: If you have them here, you are going to have them over there. We saw an illustration of this just a few weeks ago when one of the Government agencies came in here at the time the packing house industry was striking, and it came in here asking this Committee to authorize subsidies for that packing industry which, of course, if those subsidies had been granted, it would have been nothing less than that we were subsidizing the wages paid by that industry. I merely cite this illustration to show you where we are being led.

Mr. Eccles. Well, I can say this: in principle, I do not like subsidies, and I recognize that you could avoid any increase whatever in prices--for instance, in the price of steel, the Government could have given a subsidy to the steel companies of $5 a ton instead of increasing the price. You could go all the way down the line and refuse any price increase and grant subsidies, and it would be just as you say. It would merely mean that the Government would be subsidizing the increased wages. Now, certainly you would not get anywhere with that kind of a program. You would solve nothing. And I think in principle we should get away from subsidies just as quickly as we can. But I still say there may well be certain cases where it is cheaper to have subsidies, so far as the public is concerned, than it is to raise prices.

In general, of course, as I said this morning--and I would like to emphasize it--increased wages should come and must come, if we are to avoid inflationary developments, out of increased productivity per hour of labor, or out of profits. Now it may well be that there are a great

many institutions whose profits will permit them to pay increased wages. There are many. And those wages should come out of those profits instead of out of prices.

There are other instances where increased productivity would make it possible to pay higher wages.

There are other cases where some increases in price are going to be necessary, but certainly if we are going to hold the line, after we get to this new layer or level, we simply can not increase wages by a process of continuing to increase prices. Because then you have the vicious circle of increased wages, increased prices, and labor must be made to understand, along with everybody else, that any further increases after these adjustments brought about by this wage-price policy that has been put in effect have been worked out, it seems to me that future increases must come out of increased productivity of labor or out of profits that industry can afford to pay, and not out of the public through increased prices.

Mr. Smith. What worries me, Mr. Eccles, is that the laboring people now are up against the hardest proposition they have ever had to face, and which they always face when the Government prints money: that is, a depreciating currency. And I deeply sympathize with the rank and file of labor today because of that situation. That is all, Mr. Chairman.

Mr. Brown. Mr. Talle.

Mr. Talle. Chairman Eccles, I thought you presented a very good statement this morning.

Mr. Eccles. Thank you.

Mr. Talle. Last June I tried to point out that price control is merely the effect. I tried to point out that the cause we should consider would be increased production and increased prices. I was really delighted to hear your statement. We have talked a good deal about holding the line. Do you have in mind that that should be a firm line? The reason I ask is that the other day certain officials of the Office of Price Administration referred to the recent alterations in the wage situation as a bulge. Is the price line with a bulge in it the kind of line that you think of when holding the line?

Mr. Eccles. Well, I do not think that the price line, or what we call the cost of living--at least, that is what we think of it as--I do not think it is possible to hold that rigidly. I do not know that it is necessary. Certain items in the cost of living index are going to fluctuate. Certainly, there are items of course, that are in such short supply they will be pressing right up against the price ceiling. And some of those price ceilings are going to have to be broken to get production. And, as I understand the order under which the Office of Price Administration now operates, they are permitted to take into account, as a part of the cost, any increased wages that are approved by the Wage Stabilization Board, as a basis for granting increases in prices. If the earnings of a corporation are below their base period earnings, that might well require some granting of increased prices. You may find that the profits of corporations in many instances will be able to absorb those increases, and their earnings still be equal to the base period earnings.

So that there will be certain items on which increases will be

permitted, and they will press against that ceiling price granted until the supply becomes more nearly adequate.

On the other hand, there will be other items that will be in adequate supply, or in abundance, that will actually fluctuate in price, and that will need a floor to keep them from going down. I think that has been true and is likely to be true in certain food items.

Mr. Talle. It would be reasonable to say that if subsidies are paid, they would represent another bulge in the line, would it not?

Mr. Eccles. Well, if subsidies are paid, it tends to prevent a bulge in the line. Without subsidies, prices in certain categories would go up and that would tend to put the cost of living up.

Mr. Talle. The price paid in the market and the price paid by the Government, in the form of subsidy, added together, would represent a bulge, would they not?

Mr. Eccles. Well, the price paid by the Government to the extent that it can come out of taxes, would not.

Mr. Talle. That would be a happy day if we could pay them from that source.

Mr. Eccles. But, as I said awhile ago, it may be even better for the Government to pay a very small subsidy out of high cost production to get an adequate supply than to raise the whole price level for many producers that need no subsidy.

Mr. Talle. Oh, I think in the case of the metals that you mentioned, there is no question about the truth of that.

Mr. Eccles. Well, there may be cases in the packing industry. I

understand there are a lot of the smaller packing houses who can not possibly operate, whereas the big ones can.

Mr. Talle. Well, the big ones can make money out of cosmetics and athletic goods.

Mr. Eccles. They make money out of a lot of by-products and can get by, whereas the small packers can not possibly do it. Now, the question is should we increase the price of meat straight across the board for the consumer and give certain packers a greater profit than they need to, give them a profit equal to their base period earnings? Now, the excess profits tax is out, where the Government does not recapture it. If that was still in, it would not make so much difference.

Mr. Talle. We run into the differences between integrated and non-integrated industries in that situation. Would it be fair to say that black market operations represent another bulge?

Mr. Eccles. Well, I suppose that is a bulge that is pretty hard to figure. It is a bulge, all right. If we could determine the amount of goods that are purchased in the black market, but neither the seller nor the buyer advertises that fact, some are statistics that are pretty difficult to get.

Mr. Talle. Some people have said, the black market represents the price you would pay if you had no price control. With that I disagree, because an operation outside of the law is entirely a different matter, it seems to me, from a free market. It might be either higher or lower.

Mr. Eccles. I rather agree with you on that. I do not think you could certainly prove that the black market is the price you would pay if

you had no price control. It may be higher or it may be lower. It would more likely be lower, I would think.

Mr. Talle. Yes, I think so. Certainly, it would be if we continue to produce just as much. I wonder, too, about Mr. Wyatt's recommendation that we introduce accelerated depreciation. I think he calls it accelerated tax amortization. But I think that would be the same as accelerated depreciation.

Mr. Eccles. That is right. That is what it would do. It would permit new plants and machinery to be charged off more rapidly than is now permitted by the Bureau of Internal Revenue. That is, plants and machinery that were provided for the purpose of meeting this housing problem. That same thing was done during the war. Industry was permitted to get a certificate of necessity in the cases where they desired to build a war plant, and so long as they had contracts for producing war material, they could not get a certificate of non-necessity. When their business was over, they got a certificate of non-necessity, and they were then permitted to charge off, during the period in which the plant operated on war business, the entire cost of the plant.

Mr. Talle. Might have charged it off in five years instead of four?

Mr. Eccles. Some of them would. They started out at 20 percent, but they were permitted to make an amended return if they did not operate for four years. If they only operated two years, and they had taken 20 percent the first year, then, they would be permitted, as I understand it, to go back and take 50 percent the first and 50 percent the second. That, of course, was largely paid for by the Government, because those plants were

largely in the excess profits bracket, therefore, they recaptured what they otherwise would have paid to the Government for excess profits. So the Government really paid for the plants, and the industry owned them.

Mr. Talle. Actually, that is a hidden subsidy, is it not?

Mr. Eccles. It is a form of subsidy, but I think it is a form that is preferable to the direct subsidy.

Mr. Talle. Correct.

Mr. Eccles. Mr. Wyatt talked to me about some of these matters, and I made that very suggestion, that so far as it was possible, to encourage the production of prefabricated housing and other developments that he seemed to feel were necessary to get mass production, that if that could be done, by providing that any investment made for that purpose could be charged off over a short period of time--that is, over the period of time in which the industry was engaged in the production of housing for the emergency--that that would be easier to administer, it seemed to me, than to determine which concern would get a direct cash subsidy, and which one would not, that that would be a much more difficult administrative job.

Mr. Talle. Well, I have listened to your testimony with great interest. These bulges really do concern me a great deal. I realize that what we are doing here is dealing with the effects, and that is why I appreciate your original statement, in which you make those four points about production, about balancing the budget, about the capital gains tax, and stopping the monetizing of our Federal Debt. Doubtless those four points are the proper attack. Thank you.

Mr. Brown. Mr. Buffett.

Mr. Buffett. Mr. Eccles, I listened this morning with a good deal of enthusiasm to your statement, and I approved of it quite generally,

and I got a good deal of satisfaction from it, because I am glad to find that my views are in accord with those of an expert like yourself. I only wish that the Office of Price Administration, with their vast facilities for influencing public opinion and public sentiment, were carrying a similar message, or your message, to the people of this country, because I think it would do a great deal of good in the honest approach to this problem.

Mr. Eccles. I do not believe that I would find myself in any difference with Chester Bowles. I am sure that what I have said with reference to dealing with the causes, that he would fully concur in.

Mr. Buffett. Well, then, all the public information about the Office of Price Administration that I have seen in their brochures, folders, and schemes that I have seen, we will say less than 10 percent of the information contained therein related to the causes of inflation as compared with the effects of inflation. I think that is a grave error.

Mr. Eccles. Well, I suppose their role is one of controlling prices and rationing, and their role is one dealing with the effects of it. That is their statutory responsibility, to deal with the effects.

Mr. Buffett. Of course, they go a great deal further when they explain to people all about inflation, or, at least, make believe they are explaining all about inflation, and in that respect I think they have done the country quite a serious disservice, because they have not carried to the minds of the people the serious impression about the dangers of deficit spending. If they did, it would be reflected in the votes of their Congressmen, I believe. You have pointed out, I believe, that inflationary pressures continue to increase as long as deficit spending

continues; is that not right?

Mr. Eccles. Well, I would not say that. They certainly would in so far as conditions exist now. But I certainly did not feel that deficit expenditures in the period from 1933 up to 1940 created any inflationary danger. I was a very strong advocate of deficit spending on a much larger scale than was undertaken, and I do not feel that deficit spending, as such, necessarily will create inflation. But what I do say is that deficit spending during a period of short supply of goods and services, when there is already a supply of purchasing power such as we have now, that we do not want to add to it, and we can not add to it without increasing the inflationary pressures.

Mr. Buffett. That is what our discussion revolves around, the present situation.

Mr. Eccles. That is right. Now, what it might be in an indefinite future, I can not predict.

Mr. Buffett. No. We are talking about the procedure as it exists now.

Mr. Eccles. That is right. In so far as we can see it now, we certainly need a balanced budget and it would be helpful to pay something off on the public debt, if that were possible. Now, we can not reduce taxes and do these other things at the same time.

Mr. Buffett. Do you observe anything in the legislative behavior of the majority in Congress to indicate that that body is making a determined effort to balance the budget now?

Mr. Eccles. Well, I think they will all agree that it should be

done, but when it comes to voting a tax bill, it is pretty difficult, I suppose, to refuse to reduce taxes. Everybody wants the budget balanced and everybody wants their taxes reduced. So you see it is quite a problem.

Mr. Buffett. Do you think Congress will act to bring that budget into balance until forced to do so, either by a very strongly expressed public or by some unfortunate development in the economic scene?

Mr. Eccles. I think the budget may well come into balance this next year. If this wage-price policy is effective, and the line is held on the new basis, and we get full production, we will have a very large tax income during the fiscal year 1947, and our expenditures certainly should not increase beyond the budget requirements, and they may even be less.

On the other hand, if prices should go up more, that increases the cost of everything the Government has to buy, the Army, the Navy, and everything else, and we might even get a budget that is more unbalanced than is contemplated. But, as I say, that all depends upon the extent to which we can hold prices, and this legislation must be passed to enable the Office of Price Administration to do just that, and we must undertake to hold this wage-price policy in line now, and then get mass production. I mean I think that is the solution and without it we are in a pretty difficult situation.

Mr. Buffett. Is not equally important with that, getting the full production?

Mr. Eccles. Oh, well, of course, if you just do the thing theoretically, it is not worth anything. I mean there is no good in holding prices

on something that is not produced.

Mr. Buffett. Well, I noticed in a late report of the Department of Commerce that their business statistics on production, every item of production was lower than it was the same week a year ago.

Mr. Eccles. Well, production is not equal today to what it was a year ago. A year ago we were at the very peak of production. We were in a war on both fronts, and we were producing on the basis of a 200 billion dollar a year national product, which is as high as we have ever reached, and we do not expect in any specific time economy--certainly in the near future--equal to a 200 billion dollar national product.

Mr. Buffett. No, but when all the production indicators are downward, that might be cause for concern, might it not? I can see where durable goods would be down from when you were producing tanks, but the production of cotton mills should not be down.

Mr. Eccles. No.

Mr. Buffett. And the production of food should not be down.

Mr. Eccles. Well, of course, as you know, we have had some very devastating strikes, which have curtailed production, and it still is being curtailed. But it is to be hoped that it is going to be rectified within the next few weeks, so that we ought to be getting a civilian production that exceeds anything we have ever had.

Mr. Buffett. Well, there are a lot of people who feel that the Office of Price Administration pricing procedures are seriously discouraging full production now. If that should be the case, would it not be true that the Office of Price Administration could be bringing about the very

economic crisis they claim they are striving to avert?

Mr. Eccles. Well, that would be true if that is the case, but I certainly do not believe that that is the case. To take off price control on the goods--and nearly everything today is in short supply--would cause a rise here that would shock the country, and it would upset any possible labor-price relationship, and you would no more get one wage dispute settled than prices would go up all along the line, and you would run right into another wage dispute. It would be an endless inflationary cycle. I am perfectly sure, under the conditions that exist today, with this huge volume of purchasing power, I do not think there is the slightest question about it. And I do not believe that the Office of Price Administration is retarding production at all. I know that a great many producers claim that they have got to have more profits to encourage production.

I would like you to consider what happened in the 1940's when businesses operated, most of them, at a loss. They did not quit producing because there was no profit. When business operates at a loss, usually they go broke, trying to get more and more efficient, trying as best they can to meet the pressure of a loss. Sometimes an easy, big profit makes business careless about expenditures.

Mr. Buffett. There is no question that there has been a large area in which that has occurred during the war.

Mr. Eccles. That is right. And I would think that the idea of large profits being essential to stimulate production is quite a myth. I think that if a business has a good profit, with a small production, there is

not the same pressure to increase their production so as to reduce the unit cost. If there is little or no profit, on a certain volume, there is great pressure to increase that volume of production, so as to reduce the cost. Everyone knows the greater the volume of production, the lower the cost.

Mr. Buffett. Yes, but there is also a stage to be reached where the greater the volume, the more you lose.

Mr. Eccles. Well, that is correct, if your loss is great, why, of course, you might determine, if there is no way of overcoming the loss, no matter what the volume is that you may produce, you may then find that it is cheaper to shut down and absorb the loss of a closed concern than to try to operate at capacity. That is possible, but to shut down is an expensive operation. A concern not only loses its market, but it has an overhead of depreciation, taxes, insurance, maintenance, and an overhead of taxes--not profit taxes, but business property taxes--as well as the officials of the company having to be paid.

Mr. Buffett. Yes, but certainly in the brick industry last year, for example, a great many firms closed down in preference to making brick, and for six months the brick industry was cutting down.

Mr. Eccles. I think that there are some cases where you would lose less by closing. I think there are such cases, and I think the brickyard would be an example where it would not cost you an awful lot to close down. There are a great many industries, smaller ones, that might find it cheaper to close than operate, and certainly in those cases there must be adjustment of prices. And I am not advocating that we should take the profit

out of industry. All I am saying is that we should not be too ready to raise prices on the assumption that that is the only way we are going to get production, if there is a reasonable assurance that there is going to be a fair profit, a base period earnings profit, when they get volume production. Because industry, as a whole, has made fabulous profits during the war period, as evidenced by the cash and Government securities that they own now as compared with what they owned in 1940.

Mr. Buffett. Well, are not those cash and Government securities somewhat misleading in that they represent money that would normally go back for plant replacement in some cases?

Mr. Eccles. Well, some of it. But a great many concerns, their plants are in better condition today than they were in 1940, because they were able to maintain their plant at a high level, while they were in the excess profits tax bracket, and making the Government pay it, and it was to the interest of every industry, to the fullest extent that they could maintain the property, to charge it to expense, to do so. Now, there was limitation of labor and material so that it could not be done entirely, but the condition of plant and facilities, I think, is much better than many people would have us think.

On the other hand, a lot of their machinery and facilities have become obsolete due to changes, and in order to get cheaper production, large expenditures need to be made to modernize their plant facilities. I think there are a good many cases of that sort. You cannot lay down any rule in this matter.

Mr. Buffett. No, every business is different. Now, getting back to

the balanced budget, how would you answer this question: If deficit spending continues, can we prevent inflation without the use of totalitarian methods of control?

Mr. Eccles. Well, it depends on the extent of the deficit spending. It depends on how it is financed. And it depends on what it would be expended for. If deficit spending was spent for production, it certainly would not be as inflationary as if it was not expended for production.

If deficit spending was financed out of public savings and not by the banks, it would not be particularly inflationary.

Then, again, it would depend on the amount of deficit spending.

Mr. Buffett. Certainly, if there appears a very real effort to bring the budget into balance, genuinely into balance, the public confidence is going to increase.

Mr. Eccles. I am in favor of that, and I think that certainly, if we cannot balance it under a condition such as we will have during the next few years, we never can.

Mr. Buffett. There is one aspect of this problem on which I would like to get your views, because it is one that has puzzled me a great deal. We have, say, 275 billion dollars of inflationary pressure. We will produce in the next year, say, 150 billion dollars of new goods. That automatically creates 150 billion dollars of new purchasing power. How do we ever catch up with this backlog of purchasing power?

Mr. Eccles. Well, the two hundred and some odd billion dollars is not all going to be spent. Many people are going to hold their Government securities. They do not intend to spend them. They are going to keep them

indefinitely, and when one group sells, somebody else buys. So the public, as a whole, is not likely to reduce its holdings of Government securities on balance.

Mr. Buffett. If we do not do too much deficit spending.

Mr. Eccles. If they do not lose confidence in their Government credit, in the purchasing power of the dollar; that is right. We talk about that amount as being inflationary. I would say it is potential.

Mr. Buffett. Yes.

Mr. Eccles. But the savings deposits that the people have in the mutual savings banks and in savings departments of commercial banks, those should not diminish. They may increase. And the commercial deposits in currency can be spent a good many times within a year. It is a question of its velocity. It is a question of its turnover. You can get an inflation on an amount of deposits and currency that would be very much less than our national income.

Mr. Buffett. Yes, there is no question about that.

Mr. Eccles. And less than it is now, much less than it is now, if you get a sufficiently rapid turnover, and that is the danger today, of course, the rapid turnover of those deposits, such as going into the stock market, then going into the real estate markets. It is the capital goods field where the inflationary danger develops today, and that, of course, has an effect upon the whole structure. And we have done nothing, we have no mechanism, to control that.

Mr. Buffett. But still in that field, if the budget comes into balance, you are going to discourage a great deal of that.

Mr. Eccles. Psychologically, that would be helpful, certainly. But it is not a very potent factor to deal with that field.

Mr. Talle. Will you yield?

Mr. Buffett. I yield.

Mr. Talle. In the event we do not balance our budget, Chairman Eccles, and in the event that we adopt controls on properties which people buy for hedging purposes, to protect their savings, in the event that we do adopt such controls, such as, say, price ceilings on homes, or a capital gains tax, is it not conceivable that we might have a flight of dollars from our country to other countries where those controls do not exist?

Mr. Eccles. I do not think so, because they do not have the assets that our dollars want to buy. Neither do they have any stability. The inflationary danger is worse in most every other part of the world than it is here. We have the thing in control here better than possibly every other country, unless it is Canada and England. They have done a good job, particularly England, when you consider the very short supply they have of everything. Canada has done an exceptionally good job.

Mr. Talle. I do not have Canada in mind. I was thinking about Mexico.

Mr. Eccles. Well, you have an inflationary situation in Mexico that is much worse than it is here. I would not be afraid of dollars going from here to Mexico. The reverse is more likely to be true. What we have now is a flight of currency, to the extent they can get out of other countries into this country. Now, of course, they cannot leave most other countries, because those countries exercise exchange control, and a citizen of those countries has no way to transfer his money into dollars, or we

would have a flight out of most of the countries of the world into dollars, if there was any way they could get them over here.

Mr. Talle. What I had in mind there was, in the event of that happening, which I referred to, our next step would probably be--

Mr. Eccles. Exchange control.

Mr. Talle. That is right.

Mr. Eccles. Yes, sir, we would have to put on exchange control if that happened. If there was any flight of capital from here, that is exactly what we would have to do.

Mr. Buffett. Mr. Eccles, was not the steel wage increase highly discouraging to public confidence in holding of the line securities, as it were, by substantially strong-arm methods?

Mr. Eccles. It was not discouraging to me. It was encouraging, because I felt there was no point in holding the line if we did not get any steel production.

Mr. Buffett. You mean after they went on strike?

Mr. Eccles. That is right. I felt--and I think a good many other people did--that what was known as the Little Steel Formula was not going to be able to be held after the war. It was difficult enough to hold it for the last year of the war, and it was quite apparent when the war was over that there had to be some adjustment in that particular field. I was only concerned that the adjustment was not made soon enough to prevent the strikes.

Mr. Buffett. Well, now, out in the Middle West today, and in the South, transactions in grain and cottonseed cake and similar protein

products have been reduced to a large extent, all to go to either a barter or black market. Do you not think that the Office of Price Administration is taking a dangerous chance with public confidence when they ignore a situation like that, and do not make realistic adjustments?

Mr. Eccles. Well, I do not know anything about that situation, so I do not feel that I could comment upon it. I am not familiar with the black market situation that you refer to. Certainly, anything that is necessary to eliminate the black market should be done. We have got to control black markets, stop black markets. There are various ways of doing it. I suppose it is a policing job, or possibly some adjustment is necessary. As I say, I do not know, in that situation, just how that problem should be dealt with.

Mr. Buffett. I suggested to a member from Texas that perhaps 80 percent of the cotton cake was changing hands in the black market, and he said, "You are wrong; it is 100 percent." Well, when condition in an industry gets to that point, certainly it would seem that some adjustment would be appropriate. I want to thank you for your testimony. I think you have contributed a great deal to the understanding of this Committee of the basic causes of inflation.

Mr. Eccles. Thank you, Mr. Buffett.

Mr. Brown. Thank you very much for your testimony, Governor Eccles.

Mr. Eccles. Thank you. I would like to make one correction in my statement. The quotation that I gave this morning, the statement that I made before the Senate Committee, I said a year ago. It is really two years ago.

Mr. Brown. Our Committee will now adjourn to meet tomorrow morning in Executive Session.

The hearing on the Office of Price Administration will be resumed Wednesday morning at 10:30.

(Whereupon, at 4:30 o'clock p.m., the Committee adjourned, to reconvene at 10:30 o'clock a.m., Wednesday, February 27, 1946.)