THE
AMERICAN BANKERS ASSOCIATION

22 East 40 Street, New York, N. Y.

BRANCH OFFICE
719—15 STREET, N.W., WASHINGTON, D. C.

February 18, 1943.

Dear Marriner,

The president of the American Bankers Association has asked the Economic Policy Commission to make another study of the position and duties of the banks with respect to Treasury financing in the light of recent developments.

Enclosed herewith is a first draft of a report prepared in response to this request. If you could find time to read this draft and give me your suggestions we should be most appreciative.

In order to be of maximum use to the banks in preparation for the next financing, this report ought to go to press within about ten days. It would, therefore, be most helpful if your comments could reach me early next week, at 55 Wall Street.

Sincerely yours,

Randolph

Hon. Marriner S. Eccles
Chairman, Board of
Governors of the
Federal Reserve System
Washington, D. C.

THE 109 BILLION BUDGET AND THE BANKS

With the announcement of another Victory bond drive in April, the banks face a new challenge. The December drive was a success - better than any had dared hope. The banks are proud of their share in this success.

The April drive must be even better. More money is needed. A larger part of it should be obtained from individuals; the coverage must be broader if inflationary price advances are to be checked.

This task calls for understanding as well as for action for bankers are being asked to interpret to their neighbors and customers the meaning and the dangers of war finance. So it is the purpose of this report to examine the present financing problem and bring up to date the report of last April - "Treasury War Borrowing and the Banks."

The New Budget

Once more the President has startled the country with a budget of gigantic proportions - $24 billions larger than the current fiscal year's probable expenditures and six times as large as the biggest year of World War I. These relationships are shown in Diagram I (page 1-A).

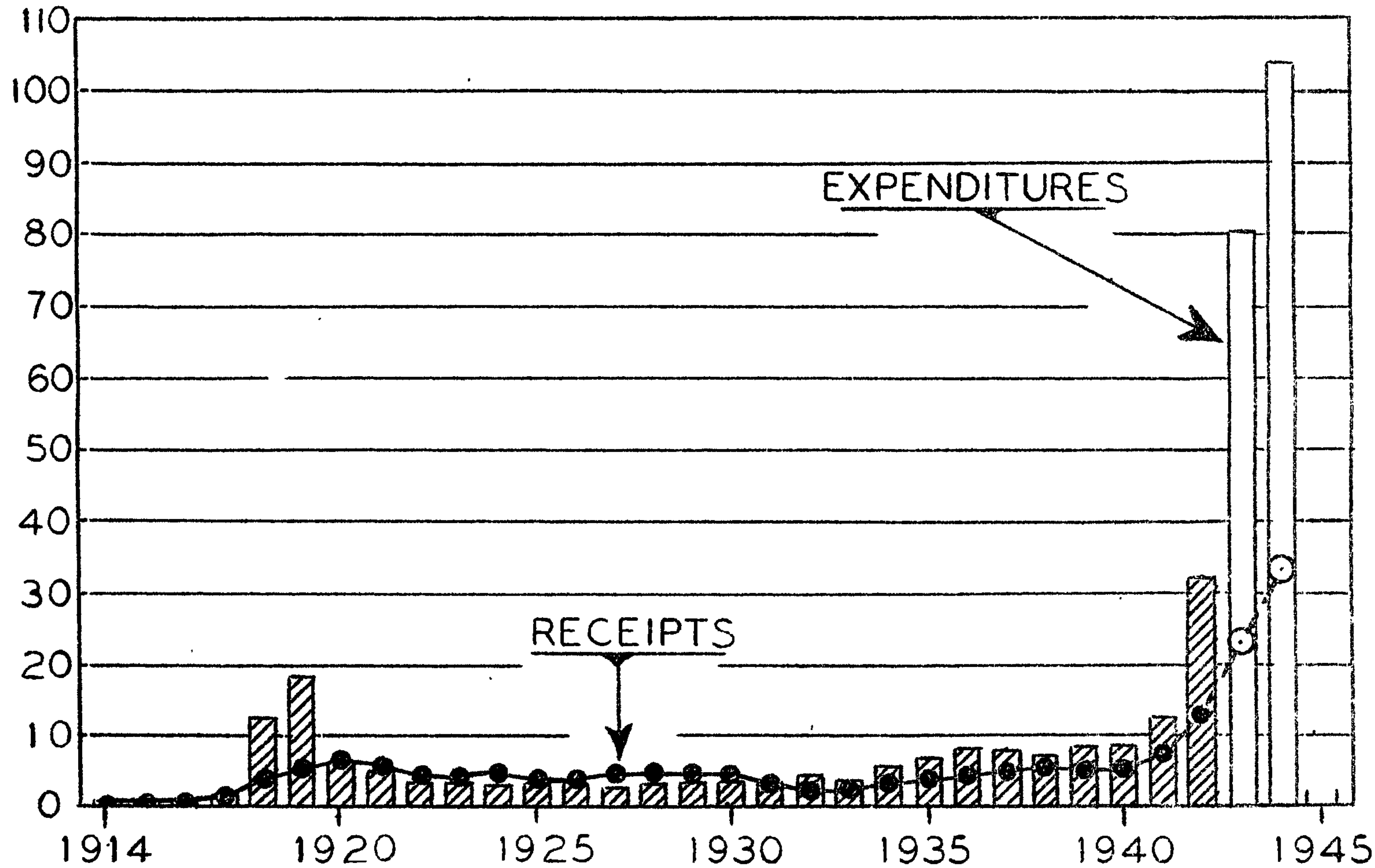
This budget is the bookkeeping aspect of a huge job of production and organization of manpower and physical forces. The objective is the ships, guns, and planes, and the men to arm them and overcome the enemy in battle.

This means an almost incredible increase in the country's output. We must produce for war alone as much as was produced for every purpose in our best years of the past, and, in addition, we must produce enough to feed and clothe our population and carry forward essential civilian services.

Diagram I

UNITED STATES RECEIPTS AND EXPENDITURES

(Billions of Dollars)



The accomplishment of this great task will require, as the President said in his message, the full harnessing of the nation's manpower and resources. "Victory," he said, "cannot be bought with any amount of money, however large; victory is achieved with the blood of soldiers, the sweat of working men and women and the sacrifice of all people."

The experience of the past two years gives confidence that the objectives set are within our reach. A year ago the budget estimate for 1942-43 spending was $59 billions. The actual figures will be nearer to $80 billions. Production goals for ships and tanks and guns and planes which seemed utterly fantastic have largely been realized, and the sights have again been raised. All along the line apparent ceilings have been lifted. It can be done.

The Inflation Threat

The task before us requires not only great national effort, but also great national restraint. This huge spending program will pour into the hands of our people vast sums; the national income will be at new high levels. Civilian But spending must be restrained because we cannot produce and import all the goods civilians would like. If spenders compete for a limited amount of goods they will knock prices sky-high; in other words, we shall have inflation.

The inflation threat, the peril of unrestrained consumer spending, is being dealt with on several fronts:

1. Price controls and rationing.
2. Taxation.
3. Bond sales to the people. Involuntary?
4. Voluntary savings.

All of these forms of restraint are necessary and we are daily learning more about them, their uses and their limitations. Especially are we learning how hard it is to make laws and rules to restrain some people without inflicting undue and perhaps unnecessary hardships on others. People who make the loudest outcry may not be those hurt most, but they may be those with most political power. The administrator of these functions needs every sympathy and every aid from patriotic citizens. 1

The banks are aiding in the administration of the rationing program as it expands to cover an increasing number of commodities. It may safely be stated that their work will be done thoroughly and efficiently and will ease the burden on the rationing administration and on business.

The country is also learning that there is no painless form of taxation which will draw off all the excess buying power and thus prevent inflationary spending. No one has yet devised a plan for extracting the spendable surplus from a war worker whose wage has jumped from $30 to $80 a week without wrecking the living arrangements of the white collar worker whose increase from $40 to perhaps $45 has failed to keep pace with the rise in his cost of living.

The tax program still leaves much to be desired, especially in reaching the newly-created income where it is and bringing a reasonable amount back into the Treasury currently. Nearly all are now agreed that some form of pay-as-you-go tax is essential and very many qualified students think a sales tax is also necessary.

But no equitable tax program can take the whole surplus income. Compulsory savings plans encounter the same limitations. There will still remain much spending power which can be reached only by voluntary means. It is in this area, which means points three and four above, that the banks have their special opportunity.

Selling Governments Outside the Banks

The December drive, under the leadership of the Victory Fund committees, was more successful than had been expected. A goal of $9 billions was set and nearly $13 billions of securities were sold, including December sales of War Savings Bonds. But at the Treasury and among the members of these committees it is recognized that only a start was made in the great task before us.

In the first place, the amounts of money required by the Government are steadily increasing. Table I shows the amount of funds to be raised through public financing in accordance with present budget estimates.

Table I

RECEIPTS - EXPENDITURES - PUBLIC FINANCING

(In Billions of Dollars)

	Fiscal 1942 Actual	Fiscal 1943 Budget	Fiscal 1944 Budget
Total expenditures including gov. corp. net outlays *	36.3	85.4	108.8
Total net receipts **	12.8	23.0	33.1***
Increase in public debt	23.5	62.4	75.7
Borrowing from trust accounts and refunding of gov. corp. obligations	3.8	4.1	5.7
Total public financing - net	19.7	58.3	70.0

* Exclusive of debt retirement.
** Exclusive of social security tax receipts
*** Exclusive of any new taxes.

In the present fiscal year, which ends on June 30, 1943, the total amount of public financing will be about $58 billions. Of this total about $34 billions was completed in the first six months, leaving something like $24 billions in the period January-June. In the next fiscal year, from June 30, 1943 through June 1944, the total to be raised will jump to $70 billions on the basis of present estimates of expenditures and present tax laws. This may and should be reduced through additional taxes but, in any event, represents a huge task if it is to be financed without serious inflationary consequences.

Also, the December financing included the sale of $5 billions of securities to the commercial banks, which is directly inflationary. It is most desirable that in the next drive a far larger proportion of the securities should be taken by other investors, and particularly by individuals. For it is money in the hands of individuals which is the chief inflationary menace.

Table 2 gives an analysis of the results of the December drive. It shows that next to the banks the largest buyers were corporations and then insurance companies. Individuals, partnerships and personal trust accounts purchased only about $1.5 billion out of a grand total of $12.9 billions.

Table 2

DECEMBER DRIVE - ANALYSIS OF BUYERS

(In Millions of Dollars)

	Net increase in Treasury Bills outstanding	Sales of other securities					Total
		7/8% Certificates of Indebt. 12-1-43	1 3/4% Treas. Bonds, 1948	2 1/2% Treasury Bonds, 1963-68	Tax Notes, Series A & C	Savings Bonds, Series E,F & G	
Banking sources	897	2,117	2,058	-	-	-	5,072
Other sources:							
Insurance companies	-	73	237	1,367	-	-	1,677
Savings banks		48	82	479	-	-	609
Other corporations	-	668	182	150	1,147	66	2,213
Individuals, partnerships, & personal trust accounts	-	118	82	253	188	948	1,589
Dealers and brokers	-	447	319	115	-	-	881
Eleemosynary institutions	-	12	10	31	-	-	53
U.S. Gov. agencies & trust funds	-	1	2	260	-	-	263
State & local governments, their agencies and sinking and trust funds	-	83	28	83	-	-	194
All other (including unclassified)	-	232	62	92	-	-	386
Total from other sources	897	1,682	1,004	2,830	1,335	1,014	7,865
Total from all sources	897	3,799	3,062	2,830	1,335	1,014	12,937

The conclusion must be drawn that, while this drive was successful in raising money and in raising a substantial part of it outside the banking system, it was not wholly successful as an anti-inflationary measure. It did not get enough money from individuals. This is shown also in the number of subscriptions. A total of 340,000 subscribers is not large in a nation of 130,000,000.

It should, of course, be added that the war savings program is steadily reaching more than 20,000,000 persons through payroll deductions but the dollar amount of these purchases is running less than half a billion dollars a month. The program is only a good beginning at absorbing the huge outflow of funds from government spending.

Another way of analyzing the results of the December financing is to compare the sales in 12 Federal Reserve districts with the total bank deposits in those districts, which are a fairly good measure of the capacity of different districts to buy government securities. These data are shown in the following table and appear to indicate that in relation to their resources some districts did a much more effective sales job than others.

Table 3

SALES OF U.S. GOVERNMENT SECURITIES IN DECEMBER 1942, EXCLUSIVE OF SALES TO BANKS. SALES IN PERCENTAGES OF TOTAL DEPOSITS, BY FEDERAL RESERVE DISTRICTS

(In Millions of Dollars)

District	Sales	Total Deposits 6/30/42	Per Cent
Boston	583.3	3,426.5	17.02
New York	3,991.2	22,080.1	18.08
Philadelphia	319.4	3,620.0	8.82
Cleveland	556.6	5,026.1	11.07
Richmond	267.1	2,742.5	9.74
Atlanta	178.4	2,403.9	7.42
Chicago	845.1	9,554.0	8.84
St. Louis	143.2	2,285.2	6.27
Minneapolis	97.3	1,370.3	7.10
Kansas City	154.3	2,412.7	6.39
Dallas	127.6	2,094.8	6.09
San Francisco	309.5	6,388.3	4.84
Total	7,573.0	63,404.4	11.94

From all these figures, it is perfectly clear that the program of selling government securities must plow deeper and reach more individuals. The December drive - to the extent that sales were made outside the commercial banks - reached primarily corporation and institutional funds which are ordinarily not inflationary. This points the way for the next drive which must be directed more largely to individuals, and especially to those individuals who are receiving the bulk of the newly-created funds.

The Next Drive

The Secretary of the Treasury has announced that the next drive to sell bonds will take place early in April. A series of conferences have been held to lay the basis for this drive. The Victory Fund committees in several districts have drawn up their suggestions and are carrying forward their plans of organization. Their representatives have met in Washington with the Treasury and officials of the Federal Reserve System. The committee of the American Bankers Association appointed by President Hemingway in November has held two meetings at the Treasury since the first of the year. Thus the whole question of the organization and methods of the drive has been reviewed and announcements will be made from time to time on specific points. In this report it seemed desirable to deal only with some of the principles which are likely to determine the success or failure of the drive.

The first point is that the banks have now demonstrated their key position in this whole enterprise, and they will be looked to for leadership and accomplishment.

A second conclusion from the December experience was that results were in proportion to the amount and quality of manpower applied, and the best results were obtained from personal interviews by bankers and investment bankers.

A third principle is that more preparation must be made ahead of time. More and better publicity is needed through both the press and the radio, to lay a background for individual appeals. The experience of the drive also indicated the need for a careful preparation of lists of prospects well in advance of the time when actual canvassing is done, removing duplications as far as feasible. It is helpful for bank presidents and others to write personal letters to these prospects before they are interviewed by salesmen. The salesmen in turn will prove more effective if they are trained specifically for this task, so that they know more about the securities that are being offered and the kind of appeal which brings the best results.

In the fourth place it now seems clear that the approach to bank depositors as such will need to be supplemented by appeals to individuals in the places where they work and through their religious and social organizations. The present organization plans for the next drive are including these additional approaches.

Answers to Two Questions

There are still a few bankers who question whether they can afford the drain on their deposits which will result from a vigorous program of sales of government securities to their depositors. This question, fortunately, is being answered by the experience of banks all over the country. For they are finding that the deposits which go out of one window through the sale of government securities come back through another window in some other account.

The whole overall program of government financing carries with it inevitably a large increase in deposits and these new deposits are finding their way into almost every bank in the country. It is true that banks in munitions production areas are growing most rapidly, but it is remarkable how the increase spreads itself out and is distributed into nearly all corners of the banking structure.

When a bank depositor buys bonds from the Government it means only a temporary reduction in deposits because the Government promptly spends the money and it comes into the hands of some other depositor. While to many this was only banking theory a few months ago, it has now been demonstrated conclusively through the experience of bank after bank. As the deposits go out through customer subscriptions for bonds or through government withdrawals, there is reasonable certainty that over a period they will return, though under different ownership.

Another question troubling bankers is how they can find the time for this effort with staffs reduced through loss of personnel to military and other service, and with the volume of work increasing. This problem finds its answer both in patriotism and in enlightened self-interest. There is no other agency in the strategic position to perform this service. Industry is heavily engaged in direct war production. The sale of bonds is the banks' great opportunity. Moreover, the record shows many cases where in the last war the banks which actively and energetically did the war work were the ones that recorded lasting growth in their volume of business. The same seems likely to be true this time. Customers want to associate themselves with institutions that are vigorous and energetic and are performing their banking function in a broad way. Also, the place of the banks in the body politic will be affected by the way they do this job. It is an unusual opportunity to demonstrate the public usefulness of the private banking system.

THE BANKS' OWN SUBSCRIPTIONS

Even after the best possible efforts to sell securities to their customers, the banks themselves will be called upon to absorb a substantial amount of government securities. ~~Diagram 2 (page 10-A) shows how~~ Their holdings have increased by leaps and bounds in the past few years, and diagram 2 (page 10-B) shows that commercial banks now hold 34 per cent of total outstanding government securities.

It is perhaps helpful to make some estimate of the probabilities for the remainder of this fiscal year. This is done in table 4 which shows to whom government bonds have been sold for the past two fiscal years, for the first six months of the current fiscal year and an estimate for the current six months.

Table 4

ACTUAL AND ESTIMATED CHANGES IN HOLDINGS OF PUBLICLY HELD DIRECT AND GUARANTEED GOVERNMENT DEBT - 1941-43

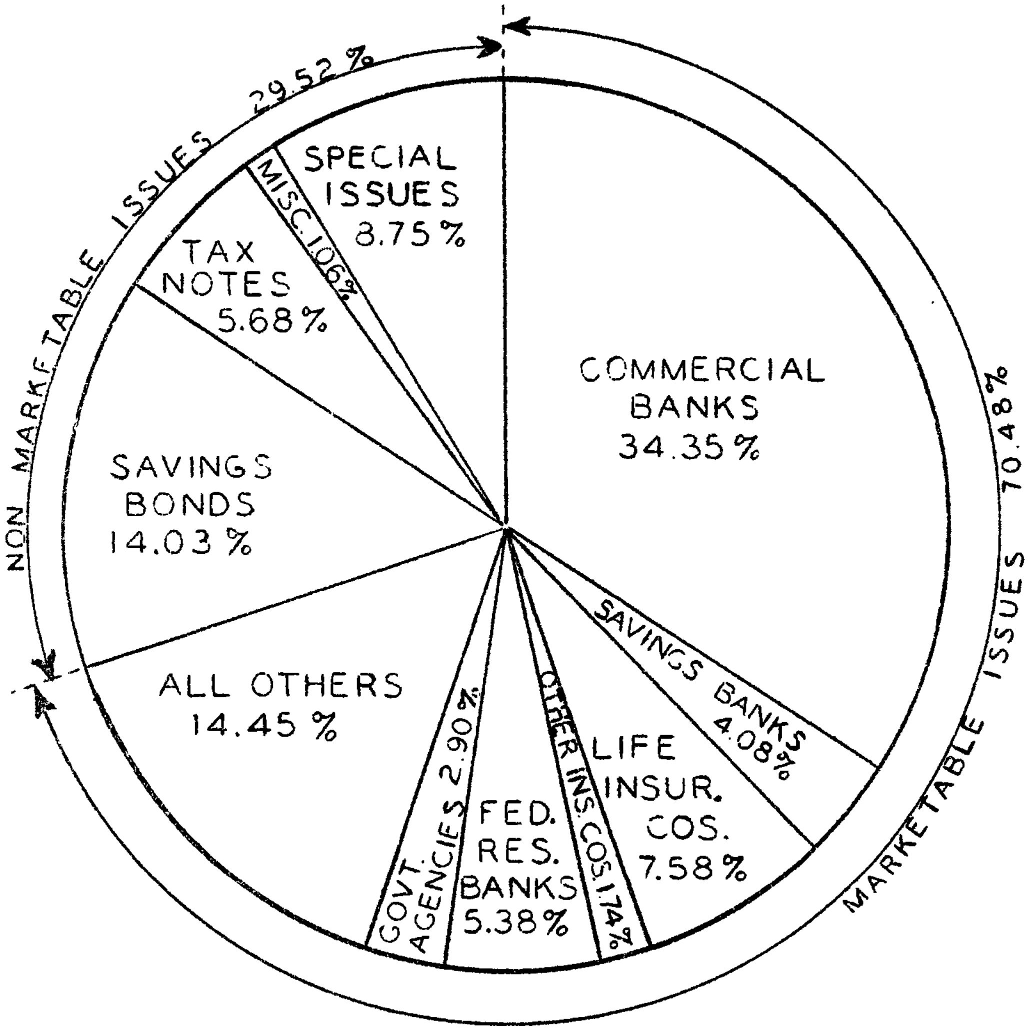
(In Billions of Dollars)

	Fiscal 1941 Actual	Fiscal 1942 Actual	Fiscal 1943 estimated: 1st 6 mos. Actual	Fiscal 1943 estimated: 2nd 6 mos. Estimated	Fiscal 1943 estimated: Full Year
War savings bonds	+ 1.4	+ 5.9	+ 4.9	+ 6.0	+ 10.9
Tax anticipation notes	-	+ 3.0	+ 3.4	+ 1.5	+ 4.9
Insurance companies	+ .4	+ 1.9	+ 2.1	+ 1.3	+ 3.4
Mutual savings banks	+ .3	+ .5	+ .7	+ .3	+ 1.0
Other	+ .1	+ 1.6	+ 4.4	+ 4.0	+ 8.4
Subtotal	+ 2.2	+ 12.9	+ 15.5	+ 13.1	+ 28.6
Commercial banks	+ 3.6	+ 6.3	+ 14.9	+ 9.3	+ 24.2
Federal Reserve banks	- .3	+ .5	+ 3.5	+ 2.0	+ 5.5
Subtotal	+ 3.3	+ 6.8	+ 18.4	+ 11.3	+ 29.7
Total	+ 5.5	+ 19.7	+ 33.9	+ 24.4	+ 58.3

Diagram 2

OWNERSHIP OF U.S. GOVERNMENT SECURITIES

November 30, 1942



These current figures will be largely determined by the success of the April drive, and they will, of course, be influenced by the tax program and many other factors. The estimate shown in the table assumes that the April drive will produce moderately better results than the December drive, though this ought to be a minimum estimate for sales outside the banks. It would suggest that the banks would be called upon to absorb about 9 billion dollars worth of government securities in the current six months' period. This is less than they purchased in the last six months of 1942 but is, nevertheless, a substantial sum which is inflationary and should be reduced to a minimum. In the coming fiscal year the amounts will be larger still.

The pattern of financing through the banks is becoming well established. While it looks like an impossibility for banks with approximately 1 1/2 billion dollars of excess reserves to buy 9 billion dollars of government securities, we have learned by experience how the process of buying these securities works out.

What happens is simply this. A bank subscribes for government securities, making the payment by an increase in its war loan account. This requires immediately an increase in its reserves,* but those reserves have in one way or another been made available as the Federal Reserve System has purchased securities in the market, or has reduced reserve requirements. For example, in the last six months of 1942 the member banks of the Reserve System bought over $13 billions of government securities and supplied depositors with $3 billions net of additional currency. Despite the

* A bill now before Congress would eliminate the requirement for reserves against government war loan deposits as well as F.D.I.C. assessment against such deposits. With this arrangement the requirement for reserve would take place only when war loan deposits are withdrawn, the funds spent by the Treasury and returned to the banks as ordinary deposits. This would make more gradual the need for added reserve.

dollar for dollar loss of reserves occasioned by currency withdrawals and despite also the increased reserves needed to back the new deposits created by government borrowing, excess reserves were reduced by only about half a billion dollars. This was mainly because the Federal Reserve Banks made $4 1/2 billions available through open market operations and through reducing the legal percentages of required reserve to deposits of central reserve city banks.

Thus the process as a whole is not difficult to understand. During the period, however, individual banks have often found themselves short of reserves through shifting of deposits, withdrawals of currency, or otherwise. The usual method of meeting this situation has been through selling Treasury bills or certificates in the market or to the Federal Reserve Banks. These channels have been freely open at all time. This period has in fact provided a demonstration of the ease of making reserve adjustments through the use of these facilities. The proof is to be found in the fact that at no time during the period has there been any substantial borrowing by member banks at the Reserve banks, although the discount rates have been reduced to 1/2 of one per cent on short governments and the Reserve System has been prepared to discount freely.

This experience suggests that the whole operation can be carried through with relatively little need for banks' borrowing at the Reserve banks. Under present circumstances there is clearly no odium attached to such borrowing, and it would rather be a sign that a bank is prepared to do its share in carrying through war financing. But any bank which does not wish to borrow is likely to find little difficulty in making adjustments in other ways.

WHAT IS EACH BANK'S SHARE?

One question frequently asked is how a bank can decide how large a subscription it ought to enter. A first principle is that banks should now be fully invested. With the large amount of Treasury bills and certificates available there is no longer any reason for a bank to carry more than a very minimum of excess reserves. To do so is to lose earnings unnecessarily. The bank carrying continuously large excess reserves is not doing its share in the program.

In fact, the weight of government financing is now being taken by banks with no excess reserves. Banks in this condition find that if they go ahead and subscribe their share for each new issue they are able to maintain their positions in ways indicated above without serious difficulty.

A second yardstick is therefore desirable to govern banks in their subscriptions, apart from their reserve position. Perhaps the simplest such measure is the percentage of the bank's deposits which is invested in government securities. On December 31, 1942 the average bank in the United States held government securities equal to nearly 50 per cent of its total deposits, and banks which are holding less than this amount might well examine their position to see whether they might not do more. This percentage would of course be a good deal influenced by a bank's loan portfolio. A bank which had a relatively large loan portfolio would not be able to subscribe quite so heavily for government securities.

Another measure which may be applied in subscribing for new issues is the ratio of a bank's deposits to the total for the country. For example, a bank with $8,500,000 of deposits holds approximately one-hundredth of one per cent of the $85,000,000,000 bank deposits of the country and might be expected to enter a subscription for at least $200,000 for a new issue of $2,000,000,000 offered to the banks.

The Treasury and the Reserve System have steadily rejected suggestions that quotas should be fixed for bank subscriptions in the belief that this was not necessary or desirable. It seems much wiser for each bank to decide its own policy in the light of the suggestions given above and in all the circumstances of its own position.

WILL DEPOSITS DISAPPEAR?

Some banks have been reluctant to become fully invested because of a feeling that their greatly expanded deposits were in the nature of fluff which would blow away with the first strong wind. They recall that in 1920 and 1921 bank deposits shrank very rapidly and compelled quite a liquidation of bank assets, and they wonder whether something like this will occur again.

The two situations are quite different, for the great expansion in bank deposits in 1917 to 1920 was in commercial loans for the purpose of carrying large inventories of commodities. When the prices of these commodities dropped the loans were liquidated and, with them, the deposits.

In the present case the expansion of deposits is due to increased holdings of government securities and the deposits would normally be liquidated as these securities are redeemed by the Government or are sold to other investors. This is likely to be a gradual operation and there may be some offsetting increases from commercial lending.

Even though the total of bank deposits is likely to change rather slowly after the war there may, of course, be substantial shifts in deposits between different regions of the country and different banks.

The answer to this problem appears to lie in the character of the securities purchased. Many careful bankers are putting a large part of their newly acquired funds into Treasury bills and certificates which can always be liquidated promptly to meet any decline in deposits but which, nevertheless, enable the bank to do its share in the financing program and to add to its income without incurring any real hazard.

The Treasury has made every effort to design the issues it has created to meet this specific problem. The volume of Treasury bills and certificates outstanding has been steadily increased. The Federal Reserve System, moreover, has maintained a constant market for Treasury bills by announcing its willingness to buy such bills at any time at 3/8 of 1 per cent and to re-sell them again at the same rate to the bank which offered them. It has in addition given support when necessary to the market for Treasury certificates. Under these circumstances banks have been justified in treating bills and certificates as the equivalent of cash.

With respect to the low yields on these securities it may be noted that they represent largely the employment of new money, so that the yield is not comparable with the usual cost of obtaining money. While it requires something of a readjustment of thinking for country banks to employ funds at rates as low as 3/8 or 7/8 of one per cent, increasing numbers of such banks are recognizing an unusual situation and employing a substantial part of their newly acquired deposits in this way.

CONDITION OF THE BANKS

Concern is sometimes expressed about the bank position with nearly 50 per cent of their assets in government securities and their capital ratio steadily declining. The changes are shown in table 5 for all member banks, with estimates for June 30, 1943.

Table 5

EFFECT OF GOVERNMENT SECURITY PURCHASES
ON ALL MEMBER BANKS, ASSUMING PURCHASES
AS INDICATED IN TABLE 4

(In Billions of Dollars)

	June 30 1941	Dec. 31 1941	June 30 1942	Dec. 31 1942	June 30 1943
TOTAL LOANS & INVESTMENTS:					
Loans	16.7	18.0	16.9	16.1	16.1
Governments	18.1	19.5	24.1	37.5	45.7
Other Investments	5.8	6.0	5.8	5.7	5.7
Total	40.6	43.5	46.8	59.3	67.5
LIABILITIES:					
Deposits	58.5	61.7	64.0	77.0	84.0 *
Capital Funds	5.8	5.9	6.0	6.1	6.2
CAPITAL FUNDS RATIOS:					
To Deposits	9.9%	9.6%	9.4%	7.8%	7.4%
To Loans and Investments	14.3%	13.6%	12.8%	10.3%	9.2%

* Allows for increase of $1.5 billion in money in circulation Jan. 1, 1943 to June 30, 1943.

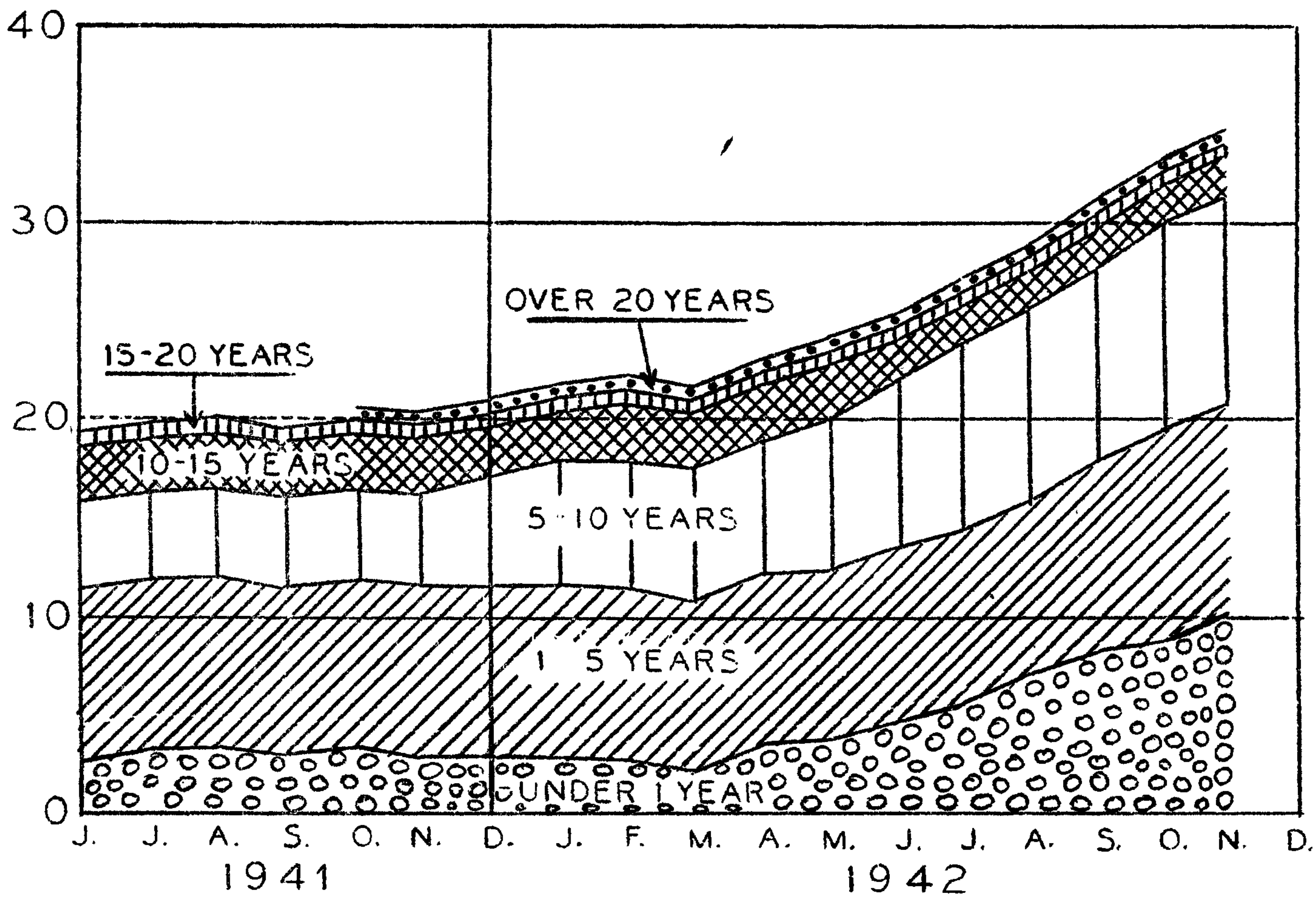
These are indeed trends which justify careful consideration and their indefinite continuance would be serious. There are certain alleviating elements. First, the decline in loans and in investments other than government securities represents a reduction in risk and in many cases a cleaning up of old sores. For some years past, for example, banks as a whole have been steadily writing down the book value of bank premises.

Second, banks have been following a conservative policy in their purchases of government securities as is shown in diagram 3. All of the increase recently has been in securities under ten years maturity (to call date) and most of it under five. More than 10 billions matures within one year.

Diagram 3

OWNERSHIP OF GOVERNMENT SECURITIES
BY COMMERCIAL BANKS, BY CALL CLASSES

(Billions of Dollars)



Under these conditions it may be stated that the amount of risk to be covered by capital has not increased. The real question is not as to the position today, which is wholly dependent on the war and the success in selling securities outside the banks, but as to the post-war position when the huge volume of bank funds may seek more active employment. It will then be desirable that the bank capital position should be strong enough to justify the banks in taking the risks necessary in financing their share of the business ventures essential to full employment. To that end it is most desirable that bank capital be augmented gradually from earnings and later perhaps by obtaining new capital in the market.

There is nothing in this situation to prevent a bank's doing its full share in the financing program provided it follows a conservative policy in the maturity of purchases, and a conservative policy also in dealing with any doubtful assets and in the payment of dividends.

DANGERS OF THE GIGANTIC DEBT

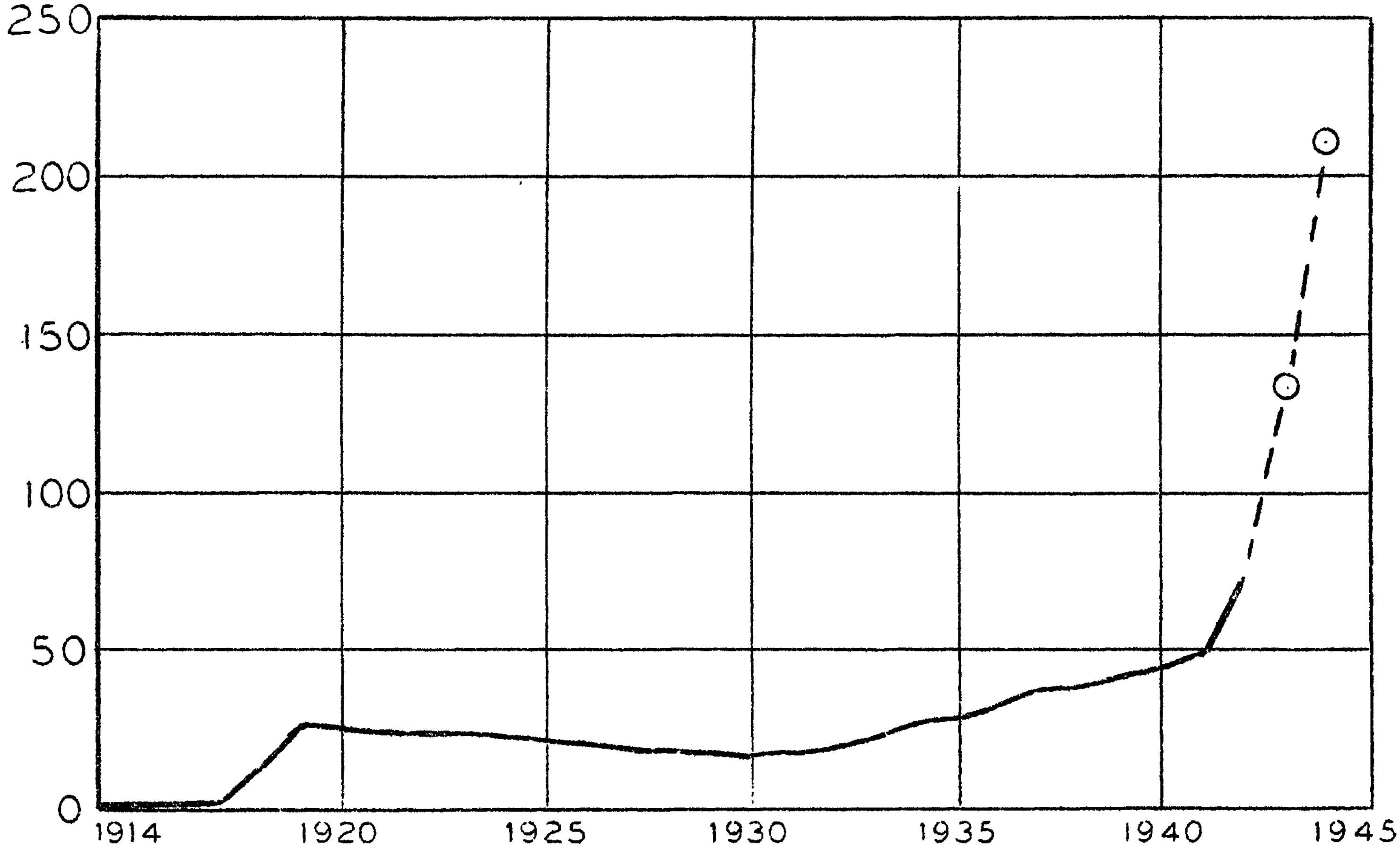
Behind all of these more technical problems lies a growing apprehension as to the effect of the mounting government debt. A few years ago a 50 billion dollar debt was dreaded as a grave danger and today we face one perhaps five or six times that large. The trend is shown in diagram 4(page 17-A). The debt will shortly reach a total twice as large as even today's greatly expanded national income.

The first and inevitable result is an annual interest cost larger than the whole national budget of a few years ago. This means higher taxes for an indefinite period and higher taxes always hurt through the discouragement of initiative and enterprise. While no one can foretell the ultimate effects of this tax burden upon the economic system, it is a risk in war we have

Diagram 4

UNITED STATES GOVERNMENT DIRECT DEBT

(In Billions of Dollars)



to take. If taxes are applied wisely and are accompanied by post-war policies that are conducive to a sound increase in national productivity and wealth, the menace in this heavy debt charge to our currency and free institutions will be lessened.

The more immediate danger attaches to the expansion of bank credit through which the huge debt is created and carried. For it is this bank credit that represents potential inflation. It is spending power in vast amounts which could blow prices through the roof if its owners started to spend it freely.

For all these recent years when bank deposits have been growing with the climbing national debt the saving grace has been an attitude of caution on the part of the owners of deposits. This had both its good and its bad aspects. Its good aspect was its avoidance of inflationary price increases. Its bad aspect a few years ago was that it slowed down recovery. The financial expansion which would in times past have stimulated business expansion and higher prices was damped down and thwarted by an atmosphere of fear and caution. Deflation was still in the air.

What happens from here on depends more on this question of attitude of mind than on the mechanics of the situation. Mechanically all the elements of a serious inflation are here, psychologically we are fortunately still somewhat cautious.

There are two things the banks can do about it. The first is to sell bonds outside the banks. This reduces the amount left for the banks to absorb, - it keeps down the mechanical base for inflation by retarding the expansion of bank credit, which is spending power.

The second and more important is to encourage a habit of thought. It is a time to teach the old fashioned doctrines of work and save. For in the thinking habits of the people lie salvation as well as in the mechanics of money. If we are spendthrift and improvident we can go haywire no matter how small the debt, but if we are industrious and saving we may survive a very large one even though it predisposes to trouble.

What we do today will in large measure decide whether we can have full employment later. Every period of under-employment in times past has been the penalty for excesses which had gone before. 1921 paid for the excesses of 1918-20, and 1932 for those of the late 20's. We keep trying to explain everything in terms of mechanics. Actually the explanation goes much deeper into the roots of human behavior.

A school of thought has developed which believes our problems can be taken in hand by government and readily solved, that government can guarantee full employment or can prevent inflation. It is possible that a totalitarian government might do these things by regimenting the people, though the proof of its ability to do so over an extended period is far from clear.

Happily in a democracy the economic life of the people is really determined not by government, though it has an important influence, but by the people themselves. If there is a spirit of enterprise among millions of people, there is full employment. If there is despair and caution there is unemployment and all the Government can do is alleviate these swings a little.

We as bankers are close to the people. They consult us in their financial and business affairs. If we are wise we can have some influence on the way the people behave under these unusual circumstances. The gospel to be taught is the one that we wholly believe, that of working and saving. If this gospel is taught and followed now it is the best way to avoid inflation now, to provide an economic support for the maximum war effort and to assure full employment after the war.

A PROGRAM FOR BANKS

By way of summary, it may be helpful to list in brief terms the desirable program for banks, that they may play their full part in financing the $109 billion budget:

1. Be an outpost for current sale of savings bonds.
2. Be prepared to advise customers and correspondent banks.
3. Organize for drives.
4. Welcome temporary loss of deposits.
5. Buy own share in percentage of deposits.
6. Use war loan account.
7. Give local leadership.
8. Preach the gospel of savings.

With the inspiring achievements of the armed forces, with miracles in production by American industry, the bankers of the country can be counted on to do their share.