WARTIME SUSPENSION OF CERTAIN PROVISIONS OF FEDERAL RESERVE ACT

HEARING

BEFORE THE

COMMITTEE ON BANKING AND CURRENCY
UNITED STATES SENATE

SEVENTY-EIGHTH CONGRESS

FIRST SESSION

ON

S. 700

A BILL TO AMEND SECTION 12B AND SECTION 19 OF THE FEDERAL RESERVE ACT DURING THE CONTINUANCE OF THE WAR AND FOR SIX MONTHS AFTER ITS TERMINATION

FEBRUARY 17, 1943

Printed for the use of the Committee on Banking and Currency

UNITED STATES
GOVERNMENT PRINTING OFFICE
63118 WASHINGTON : 1943

COMMITTEE ON BANKING AND CURRENCY

ROBERT F. WAGNER, New York, *Chairman*

CARTER GLASS, Virginia
ALBEN W. BARKLEY, Kentucky
JOHN H. BANKHEAD, 2d Alabama
FRANCIS MALONEY, Connecticut
GEORGE L. RADCLIFFE, Maryland
D. WORTH CLARK, Idaho
SHERIDAN DOWNEY, California
ABE MURDOCK, Utah
BURNET R. MAYBANK, South Carolina
JAMES G. SCRUGHAM, Nevada
JOHN L. McCLELLAN, Arkansas

CHARLES W. TOBEY, New Hampshire
JOHN A. DANAHER, Connecticut
ROBERT A. TAFT, Ohio
JOHN THOMAS, Idaho
HUGH A. BUTLER, Nebraska
ARTHUR CAPPER, Kansas
JOSEPH H. BALL, Minnesota
C. DOUGLASS BUCK, Delaware

PHILIP LEVY, *Clerk*

CONTENTS

EXHIBITS

WARTIME SUSPENSION OF CERTAIN PROVISIONS OF FEDERAL RESERVE ACT

WEDNESDAY, FEBRUARY 17, 1943

UNITED STATES SENATE,
COMMITTEE ON BANKING AND CURRENCY,
Washington, D. C.

The committee met, pursuant to call, in room 301, Senate Office Building, at 10:30 a. m., Senator Robert F. Wagner, chairman, presiding.

Present: Senators Wagner (chairman), Barkley, Maloney, Radcliffe, Maybank, Scrugham, McClellan, Tobey, Danaher, Thomas of Idaho, Butler, Capper, and Ball.

Also present: Leo T. Crowley, Chairman, Federal Deposit Insurance Corporation; Marriner S. Eccles, Chairman, Federal Reserve Board; John K. McKee, Governor, Federal Reserve Board; Francis C. Brown, Solicitor, Federal Deposit Insurance Corporation; Donald S. Thompson, Chief of Division of Research, Federal Deposit Insurance Corporation.

The CHAIRMAN. The committee will come to order.

The committee has for consideration S. 700, a bill to amend section 12B and section 19 of the Federal Reserve Act during the continuance of the war and for 6 months after its termination.

The bill under consideration, S. 700, is as follows:

A BILL To amend section 12B and section 19 of the Federal Act during the continuance of the war and for six months after its termination

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the second sentence of paragraph (1) of subsection (h) of section 12B of the Federal Reserve Act (U. S. C., title 12, sec. 264 (h) (1), as amended, is hereby further amended by substituting a colon for the period at the end thereof and adding the following: "*And provided further,* That during the continuance of the present war and for six months after its termination any balance payable to the United States by any insured bank, whether represented by a deposit account or otherwise, arising solely as a result of subscriptions made by or through such insured bank for United States Government securities issued under authority of the Second Liberty Bond Act, as amended, shall be excluded from the definition of 'deposit' for the purpose of determining the assessment base."

SEC. 2. That the last sentence of section 19 of the Federal Reserve Act (U. S. C., title 12, sec. 462a–1) be amended by substituting a colon for the period at the end thereof and by adding the following: "*Provided,* That during the continuance of the present war and for six months after its termination no deposit payable to the United States by any member bank arising solely as the result of subscriptions made by or through such member bank for United States Government securities issued under authority of the Second Liberty Bond Act, as amended, shall be subject to the reserve requirements of this section."

The CHAIRMAN. Mr. Crowley, you are one of those who asked me to introduce this bill on behalf of the Federal Deposit Insurance Corporation, so if you are prepared we would like to hear from you with reference to the legislation. I assume that all of you gentlemen know Mr. Crowley, of course.

STATEMENT OF LEO T. CROWLEY, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION, WASHINGTON, D. C.

Mr. CROWLEY. Senator, we appreciate the opportunity to come before your committee. We do not come here very often, and we are glad to be able to come and suggest that we give up some powers and some income, which I think is rather contrary to the average history of most of our agencies.

Senator TOBEY. You say "give up some powers"?

Mr. CROWLEY. Yes, sir.

Senator TOBEY. That is a new term around here, sir.

Senator BARKLEY. I move the report be adopted. [Laughter.]

Mr. CROWLEY. We have prepared some testimony here which I would like to have included in the record and I presume what you would like to know, generally speaking, what it covers. The thing that this bill does is to eliminate the insurance assessment on the so-called war-loan account. That is an account that is used by the banks as an account for the Treasury between the time the securities are purchased and the Treasury uses the money in the general flow of its expenditures.

We anticipate that will cost us about $4,000,000 a year. That, of course, will be determined by the amount of the financing that will be necessary to carry on the war; it is based upon estimated Treasury borrowings of about $60,000,000,000 a year.

Our income for 1942 was approximately 55 million, and for 1943 we estimate it to be about 70 million. That, of course, is due to increases in the deposit liability of the banks.

As to the insured banks for the years 1943 to 1945, we anticipate a net income after taxes of from 400 to 500 million dollars a year.

We support this bill because the Treasury has told us that the exemption of this account from the one-twelfth of 1 percent assessment would increase the willingness of the insured banks to help finance the war, and would stimulate the sale of Government bonds.

We have a table in here that shows the losses of the commercial banks of the country from 1865, during the various periods of depression. Based upon the studies we have made, the best that we can make, such a theoretical fund would have been insolvent two or three times during that period, based upon the losses of the past, so therefore we are reluctant to recommend any further reduction in our assessments, other than the elimination of this account, because we feel, with the post-war readjustment that faces us, that we should, during this period, build up as much reserve as we possibly can, for the elimination of unsound banks and the protection of the depositors after the war.

The banking system today is, perhaps, asset-wise, in the best shape that it has ever been in. I think the total amount of criticized assets is relatively small—2.5 percent of total assets—in other words, about 97.5 percent of assets are not subject to criticism. That is the best report in the history of the country.

We have, during the life of Deposit Insurance, built a capital and surplus of 615 million. When the fund was set up, we felt that any fund of 500 or 600 million dollars would be ample to take care of the ordinary losses in the banking system. But, of course, we did not anticipate the war with its post-war problems, and the enormous growth in bank assets and liabilities that we have now and face in the future.

We could liquidate the Federal Deposit Insurance Corporation today, pay the Government back the $289,000,000 that they put into us, and all the money that we have had from the banking system, and pay a dividend to the Treasury of about 7 percent on the investment that they have had in our fund.

During the 9 years of our operation we have taken care of about 1,266,000 depositors in closed banks throughout the country.

The CHAIRMAN. How many?

Mr. CROWLEY. One million, two hundred sixty-six thousand; most of them without any loss.

The total loss during the life of our fund to uninsured depositors in insured banks would run less than $3,000,000, since our fund started, so, practically speaking, there has been no loss to an insured depositor during that period.

The CHAIRMAN. Mr. Crowley, how many bank failures have there been during that period?

Mr. CROWLEY. Three hundred ninety during that period including mergers. And, with the exception of two or three States, the banking system, asset wise, is in very favorable condition. We are working hard to try to get these banks to eliminate as much of their other real-estate and other undesirable assets as they possibly can during this period, because we know when it is over they will have great difficulty in moving so-called criticized assets.

Senator TOBEY. What was the date of the origin of F. D. I. C.?

Mr. CROWLEY. The act was passed in June 1933, and it was set up in September 1933, and insurance went into effect on January 1, 1934.

Now, does that cover about everything, Mr. Thompson, that we have? We will be glad to answer any questions, Senator Wagner, that you may desire to ask. That about covers our position on the bill. We ask that this statement be made a part of our presentation.

(The prepared statement referred to is as follows:)

TESTIMONY OF LEO T. CROWLEY, CHAIRMAN OF THE FEDERAL DEPOSIT INSURANCE CORPORATION, BEFORE THE SENATE COMMITTEE ON BANKING AND CURRENCY RE S. 700, WEDNESDAY, FEBRUARY 17, 1943

I am here to explain the position of the Federal Deposit Insurance Corporation with respect to the exemption of war-loan deposits from insurance assessments, as proposed by S. 700. Since the proposal to eliminate reserve requirements on war loan deposits (sec. 2 of the bill) affects the operations of the Federal Reserve System primarily, I prefer not to comment upon that phase of the bill.

War-loan deposits.—A description of how the war-loan deposit account operates may be useful in understanding the effect upon the banks of the elimination of the deposit insurance assessment on these deposits.

The war-loan deposit account results from two types of transactions, each of which involves the sale of securities by the Treasury. The two transactions are the direct purchase of new issues by a bank and the purchase through a bank of new issues by an individual or firm. When the bank subscribes to a new issue it creates on its books a credit to the Treasury in a war-loan deposit account. When an individual or firm buys through a bank he gives the bank a check. The bank charges the account of the individual or firm (thereby reducing that account) and credits the Treasury's war-loan deposit account, increasing it correspondingly. The Treasury draws upon its war-loan deposit account as it needs the money. The withdrawals are gradual and fairly regular over a period of time. When the Treasury withdraws money from a war-loan deposit account and disburses it, the money goes back into the hands of bank customers, and deposits of individuals and business enterprises increase correspondingly.

Upon the securities which it buys the bank receives interest from the date of purchase and is prohibited by law from paying interest on the deposit owed to the

Treasury. The average rate of interest received on securities purchased by the banks in 1942 was about 1 percent per annum. In effect, therefore, the banks pay on an instalment basis with no down payments and no interest for securities upon which they average a return of 1 percent per annum; they also sell to customers for cash, securities for which they do not have to make immediate remittance to the Treasury. Put another way, after deducting insurance assessments of one-twelfth of 1 percent the banks receive a net income at the rate of about eleven-twelfths of 1 percent per annum on funds they have promised to loan, but haven't yet actually turned over, to the Treasury.

Effect of bill upon the Corporation and upon the banks.—Treasury borrowings for the fiscal year 1943 were estimated to amount to about $60,000,000,000 in the President's budget. So long as the Treasury borrows at this rate, we estimate that war-loan deposits in insured banks will probably average $3,000,000,000 and that insurance assessments thereon would amount to about $2.5 million per year. The Corporation's income from assessments in 1942 was slightly over $55,000,000; for 1943, it will be about $70,000,000, according to our present estimates. Insured bank profits are currently running between $450,000,000 and $500,000,000 after taxes. The financial effect upon either the banks or the Corporation of the elimination of assessments on war-loan deposits does not appear to be very important. With the growth in deposits total assessments paid in future years will, of course, be larger in amount. Should deficit financing exceed $60,000,000,000 in a year the amount of the war-loan deposits would probably be correspondingly higher.

The chart (chart A) which I have here shows net monthly receipts of the Treasury on public debt transactions and average monthly balances in the war loan deposit accounts from January 1940 to January 1943, inclusive. The data are presented in table 1. The net monthly receipts are plotted on a scale which is double that used for the deposit balances, because in 1941 and 1942 (as the chart shows) the Treasury's net monthly public debt receipts were about double the average amount of war-loan deposits. It is on this basis that we have estimated the effect of this bill (S. 700) upon the banks and the Corporation.

The exemption of war-loan deposits from the assessment and from reserve requirements will practically eliminate the cost of handling such deposits. As a consequence, war-loan deposits will be very profitable accounts.

The Corporation supports the bill as a war measure.—We have been told that many bankers have made representations to the Treasury to the effect that they are loath to participate in the handling of war-loan deposits because of our assessment of one-twelfth of 1 percent per annum. As a consequence, the Treasury has requested this exemption as a war measure to facilitate war financing. The exemption is to be effective only for the duration of the war and for 6 months thereafter and we approve the provisions of the pending bill, strictly as a war measure.

TABLE 1.—*War-loan deposits and Treasury net borrowings, monthly, 1940–43*

[In millions of dollars]

Month	1940		1941		1942		1943	
	War loan deposits[1]	Treasury borrowings[2]	War loan deposits[1]	Treasury borrowings[2]	War loan deposits[1]	Treasury borrowings[2]	War loan deposits[1]	Treasury borrowings
January	819	167	506	852	1,787	2,074	7,030	2,899
February	816	256	478	213	1,658	2,369		
March	815	175	475	1,083	2,162	39		
April	814	118	554	58	2,079	2,542		
May	813	150	552	490	1,690	3,609		
June	811	160	652	1,241	1,077	3,852		
July	653	803	672	551	1,833	4,714		
August	718	135	751	1,408	2,459	4,549		
September	716	168	828	425	1,167	4,798		
October	714	64	578	2,238	2,569	6,420		
November	712	136	845	1,456	2,320	3,212		
December	625	752	1,345	2,898	5,537	12,054		

[1] Daily average of special deposits on account of sales of Government securities.
[2] Monthly excess of public-debt receipts over expenditures.

The Corporation does not consider other reduction or exemption advisable.—We do not consider advisable any other reduction in the assessment whatsoever, nor the exemption from assessment of any other class or type of deposit. Our reasons are set forth below.

Losses versus assessments.—We have no assurance that the present rate of assessment is adequate to meet future needs. From 1865 to 1940, losses to depositors in closed banks would have averaged one-fifth of 1 percent per annum of deposits in all commercial banks if, as has been the case in recent years, there had been no stockholders' double liability throughout the period. Those losses are more than double the present rate of assessment. Had there been no major post-war adjustments and no major banking crises during that 76-year period, the rate of loss would have been just about equal to our present rate of assessment.

The favorable experience of the Corporation over the past 9 years is characteristic of similar periods of recovery from major banking crises. This is brought out by the accompanying chart (chart B). The supporting figures are presented in table 2. The chart shows that if a deposit insurance fund had been established at the close of the Civil War with the same rate of assessment and the same capital in relation to deposits, and the same relative borrowing power as the Federal Deposit Insurance Corporation, it would have enjoyed a favorable record in early years but would have become insolvent in 1877. Reestablished in 1880, the fund again would have enjoyed an early favorable record but would have become insolvent again in 1893. Reestablished in 1898, once more it would have enjoyed an early favorable record but would have become insolvent for the third time in 1930. The banking collapse of 1933 would have removed any hope of restoring solvency to the insurance fund.

TABLE 2.—*Total resources of hypothetical deposit insurance funds, 1865–1933, and of Federal Deposit Insurance Corporation, 1933–42*

TOTAL RESOURCES

Year end	In thousands of dollars	As percent of bank deposits [1]	Year end	In thousands of dollars	As percent of bank deposits [1]
1865	7,225	1.07	1874	8,798	0.68
1866	7,321	.79	1875	4,902	.37
1867	7,623	.78	1876	2,773	.21
1868	8,548	.80	1877	−1,283	−.10
1869	9,582	.81	1878	−9,418	−.78
1870	10,822	.89	1879	−10,962	−.75
1871	11,108	.85	1880	−11,036	−.64
1872	11,376	.93	1881	−11,418	−.55
1873	9,153	.76			
NEW FUND STARTED					
1880	13,621	0.79	1906	85,969	0.66
1881	14,226	.68	1907	79,727	.61
1882	14,354	.68	1908	75,165	.55
1883	15,285	.69	1909	79,427	.53
1884	11,655	.54	1910	86,515	.55
1885	11,325	.49	1911	95,790	.58
1886	12,857	.51	1912	107,691	.61
1887	12,958	.44	1913	119,300	.66
1888	14,045	.44	1914	128,698	.69
1889	16,162	.46	1915	140,107	.67
1890	15,910	.43	1916	160,700	.64
1891	10,011	.26	1917	184,757	.64
1892	10,736	.25	1918	211,135	.70
1893	−9,634	−.24	1919	242,411	.69
1894	−13,544	−.31	1920	263,298	.71
1895	−16,337	−.37	1921	249,309	.73
1896	−20,488	−.48	1922	250,203	.70
1897	−25,688	−.54	1923	232,159	.60
1898	−25,864	−.45	1924	202,056	.48
1899	−25,257	−.37	1925	185,916	.41
1898	44,280	.78	1926	150,956	.32
1899	47,693	.71	1927	135,367	.28
1900	52,084	.69	1928	133,175	.26
1901	56,721	.65	1929	105,114	.21
1902	63,258	.67	1930	−18,573	−.04
1903	70,046	.71	1931	−289,498	−.65
1904	71,970	.66	1932	−441,594	−1.20
1905	77,911	.65	1933	−812,753	−2.44

[1] Total deposits of all commercial banks.

83118—43——2

TABLE 2.—*Total resources of hypothetical deposit insurance funds, 1865–1933, and of Federal Deposit Insurance Corporation, 1933–42*—Continued

FEDERAL DEPOSIT INSURANCE CORPORATION

Year end	In thousands of dollars	As percent of bank deposits	Year end	In thousands of dollars	As percent of bank deposits
1933	289, 300	0. 87	1938	421, 622	0. 85
1934	333, 283	. 89	1939	456, 114	. 83
1935	337, 210	. 79	1940	497, 209	. 81
1936	353, 172	. 73	1941	555, 662	. 81
1937	385, 340	. 79	1942	620, 000	. 80

At the beginning of deposit insurance the Corporation's resources amounted to about 1 percent of total deposits of insured banks. Today, our resources amount to about three-fourths of 1 percent of deposits. Three years from now, if present tendencies continue, the ratio will be even lower (two-thirds of 1 percent). Of course, a major part of the growth in deposits is being accompanied by a corresponding growth in bank holdings of Government securities and later will probably be accompanied by some increase in reserves.

In that connection, I should like to show the committee this chart (chart C) which gives deposits of all commercial banks in the United States from 1865 to 1945, and our estimates of the volume of deposits for 1943, 1944, and 1945, if present financing tendencies continue. The supporting figures are given in table 3. The period from 1934 to 1942 is the period of operation of the Federal Deposit Insurance Corporation. Widespread failures and heavy losses ordinarily do not occur during such a period of recovery and growth, particularly following such a thorough housecleaning as took place in the period 1930–33. An intensive program of rehabilitation was also undertaken by the Federal Deposit Insurance Corporation during the early years of its existence to further strengthen the banking system so that many banks were restored to health which might otherwise have become insolvent and been forced to suspend operations even during the period of recovery.

TABLE 3.—*Deposits of all commercial banks, 1865–1945—Estimated average deposits by years*

[In millions of dollars]

1865	677	1893	4, 070
1866	924	1894	4, 303
1867	980	1895	4, 412
1868	1, 068	1896	4, 313
1869	1, 181	1897	4, 791
1870	1, 217	1898	5, 699
1871	1, 302	1899	6, 743
1872	1, 218	1900	7, 576
1873	1, 211	1901	8, 749
1874	1, 336	1902	9, 429
1875	1, 343	1903	9, 876
1876	1, 300	1904	10, 939
1877	1, 297	1905	12, 069
1878	1, 214	1906	12, 946
1879	1, 458	1907	13, 176
1880	1, 727	1908	13, 713
1881	2, 078	1909	15, 004
1882	2, 125	1910	15, 730
1883	2, 202	1911	16, 605
1884	2, 176	1912	17, 515
1885	2, 299	1913	18, 041
1886	2, 534	1914	18, 695
1887	2, 930	1915	20, 972
1888	3, 169	1916	25, 242
1889	3, 533	1917	28, 752
1890	3, 713	1918	30, 254
1891	3, 924	1919	35, 171
1892	4, 365	1920	37, 301

TABLE 3.—*Deposits of all commercial banks, 1865–1945—Estimated average deposits by years*—Continued

[In millions of dollars]

1921	34, 011	1934	37, 482
1922	35, 891	1935	42, 796
1923	38, 430	1936	48, 125
1924	41, 776	1937	48, 932
1925	44, 808	1938	49, 345
1926	46, 475	1939	54, 912
1927	48, 397	1940	61, 374
1928	50, 293	1941	68, 614
1929	50, 398	1942	77, 200
1930	49, 489	1943 [1]	99, 000
1931	44, 687	1944 [1]	122, 000
1932	36, 668	1945 [1]	147, 000
1933	33, 252	1945 [1,2]	160, 000

[1] Estimated. [2] Year end.

Protection of depositors in closed insured banks.—From the beginning of deposit insurance to December 31, 1942, 393 insured banks were closed because of financial difficulties. Of these, 3 were subsequently reopened or taken over by other insured banks, and 390, having 1,266,000 depositors with total deposits of $485,000,000, were liquidated or merged with the aid of loans from the Corporation. Deposits amounting to $474,000,000 or 97.8 percent of the total deposits in the 390 banks, were made available promptly without loss to the depositors. Only 1,966 of the 1,266,000 depositors, or less than one-fifth of 1 percent, held accounts in excess of $5,000 and were not fully protected by insurance, offset, preferment, pledge of security, or terms of the merger agreements. It is estimated that these depositors will lose less than $3,000,000, or about one-half of 1 percent of the deposits in these banks. The Corporation's losses are estimated at $50,000,000.

Deposits and losses in closed insured banks, 1934–1942, inclusive

	Total	Merged	Placed in receivership
Number of banks	390	150	240
Number of depositors	1, 266, 000	902, 000	364, 000
Amount of deposits	$484, 900, 000	$382, 400, 000	$102, 400, 000
Amount of protected deposits	$474, 200, 000	$382, 400, 000	$91, 800, 000
Amount of Corporation disbursements	$250, 900, 000	$169, 700, 000	$81, 200, 000
Amount of estimated losses to—			
Federal Deposit Insurance Corporation	$50, 300, 000	$28, 900, 000	$21, 300, 000
Depositors	$2, 800, 000	None	$2, 800, 000

Condition of banks today.—The quality of the assets of the banks today is better than at any other time of record. Total assets of the banks were appraised by examiners at 99.8 percent of book value in 1942, compared with 99.4 percent in 1939 and probably not over 90 percent in 1933–34. Only 2.5 percent of the assets were considered to be substandard in 1942, compared with at least 25 percent in 1933–34. In 1942, more than 97 percent of the assets were not criticized; in 1933–34, less than two-thirds of the assets of the banks escaped criticism. The improvement has reflected in part the elimination of weak and insolvent banks, in part the charging off by operating banks of more than $4,000,000,000 of losses during the past 9 years, in part improvement in credit standing of debtors accompanying business recovery and rising incomes, and in part the acquisition by banks of a large volume of new assets consisting chiefly of United States Government obligations, cash and balances with other banks, and sound loans.

With assets in excellent shape generally and reserves ample and flexible, the banks are able to support whatever financial program may be necessary to win the war.

Post-war banking adjustments.—When this war is over we again will turn our energies to peacetime pursuits. A tremendous problem of conversion will then face us. Business will require financing in order to convert and reequip factories and plants, to reopen channels of distribution and, most important of all, to permit the small independent business man to reestablish his business. This financial responsibility will fall chiefly upon the banks. If our banking system is to continue to justify its existence it must be ready to meet this responsibility. Business may have to be financed without reduction in bank holdings of United States Government obligations. Deposits may increase further. We do not know what adjustments will be called for after the war but we do know that they will be beyond any scale contemplated before this war. With deposits greatly above present levels and demands for business accomodation piled on top of that, the only protection which bank depositors will have will lie in the character of assets held by the bank, in the bank's capital cushions, and in deposit insurance.

I should like to present to this committee another chart (chart D) which compares the capital accounts of national banks with their assets. Data for national banks are used in this instance because they are the best figures available over a long period of time. If figures for all banks, National and State, were used the story would be about the same. The figures are given in table 4. The lower curve shows the amount of capital accounts for each $100 of assets held by the banks; the upper curve shows the amount of capital accounts for each $100 of assets held in the form of loans, securities other than United States Governments, and fixed and miscellaneous assets. In other words, "cash and Governments" have been eliminated. The chart shows that even after the elimination of "cash and Governments," capital ratios are now lower than at any previous time except during the period 1916 to 1932. The sequel to that period of bank credit expansion was the closing during 1921–33 of more than 2,700 national banks because of financial difficulties, with losses to depositors estimated at $480,000,000. The dotted line represents our best estimates as to what the ratios will be in 1943, 1944, and 1945.

TABLE 4.—*Total capital accounts per $100 of assets of national banks, 1865–1945*

June 30—	Total capital accounts per $100 of—		June 30—	Total capital accounts per $100 of—	
	Total assets	Selected assets [1]		Total assets	Selected assets [1]
1865	$33.76	$97.87	1906	$19.16	$28.96
1866	33.44	84.01	1907	18.92	27.99
1867	34.33	80.96	1908	19.14	28.91
1868	33.68	75.49	1909	18.41	27.87
1869	35.08	74.45	1910	18.70	27.90
1870	35.88	72.44	1911	18.62	27.72
1871	34.88	70.03	1912	18.27	26.81
1872	35.35	67.19	1913	18.53	26.83
1873	35.77	66.87	1914	17.85	25.79
1874	36.48	67.68	1915	17.85	25.22
1875	35.90	64.16	1916	15.10	21.31
1876	37.18	65.85	1917	13.50	19.11
1877	36.99	65.10	1918	12.26	17.64
1878	35.94	66.96	1919	11.13	17.01
1879	30.46	65.13	1920	11.27	15.76
1880	30.68	56.19	1921	13.65	18.61
1881	27.59	50.43	1922	13.80	19.74
1882	28.17	49.21	1923	13.40	18.99
1883	29.90	49.51	1924	12.94	18.66
1884	32.37	52.09	1925	12.24	17.51
1885	29.94	51.65	1926	12.25	17.21
1886	30.73	48.83	1927	12.24	17.05
1887	30.57	46.88	1928	12.63	17.19
1888	30.82	46.76	1929	13.47	18.20
1889	29.79	44.54	1930	13.77	19.21
1890	30.52	43.73	1931	13.67	19.54
1891	31.72	45.30	1932	14.67	21.13
1892	28.94	42.51	1933	13.70	22.48
1893	32.02	45.26	1934	12.56	24.60
1894	29.26	44.61	1935	11.85	25.69
1895	28.44	42.48	1936	10.66	24.60
1896	29.31	43.13	1937	10.59	23.39
1897	27.01	41.81	1938	10.78	25.30
1898	24.01	37.53	1939	10.22	25.42
1899	20.02	32.28	1940	9.43	25.02
1900	20.49	32.41	1941	8.71	22.98
1901	18.72	29.98	1942	8.23	23.78
1902	19.71	30.66	1943	[2] 6.10	[2] [3] 26.00
1903	20.45	30.85	1944	[2] 5.10	[2] [3] 29.00
1904	20.26	30.66	1945	[2] 4.30	[2] [3] 31.00
1905	19.20	29.20			

[1] Loans, securities other than U. S. Government obligations, and fixed and miscellaneous assets.
[2] Estimated.
[3] These ratios assume a decline in the volume of loans, securities other than U. S. Government obligations, and fixed and miscellaneous assets. If these assets should not decline the ratios would be as follows: 1943, $24.80; 1944, $25.50; 1945, $26.20.

While many of the loans to industry for war purposes will be liquidated when the war is over, we may well expect many of them to be replaced by other loans with a consequent increase in the total volume of bank credit extended to private business. With their continually narrowing capital margins banks will be more vulnerable than formerly to shifts in economic fortunes. In that event, confidence in the banking system will depend almost wholly upon the integrity and soundness of the Federal Deposit Insurance Corporation.

Favorable outlook for bank earnings and profits.—The impact of the war has been felt in a very uneven manner by the banks. Some have had an enormous growth of deposits and assets, some have had little growth, and some have even lost deposits. These disparities are the inevitable consequence of the profound adjustments required by war and impose difficult burdens upon some banks as well as on numerous other types of businesses.

Viewing the banks as a whole, however, earnings are increasing. While it is difficult to forecast all of the factors involved—such as the rate of return on Governments acquired, the changes in other sources of earnings, future expenses and charge-offs, recoveries, and taxes—we estimate that profits will increase sufficiently to cover increased taxes and that net profits after taxes for the banks as a whole will continue to range between $400,000,000 and $500,000,000. Thus the increased taxes of the banks will be paid for out of increased earnings rather than reduced profits.

While many of the loans to industry for war purposes will be liquidated when the war is over, we may well expect many of them to be replaced by other loans with a consequent increase in the total volume of bank credit extended to private business. With their continually narrowing capital margins banks will be more vulnerable than formerly to shifts in economic fortunes. In that event, confidence in the banking system will depend almost wholly upon the integrity and soundness of the Federal Deposit Insurance Corporation.

Favorable outlook for bank earnings and profits.—The impact of the war has been felt in a very uneven manner by the banks. Some have had an enormous growth of deposits and assets, some have had little growth, and some have even lost deposits. These disparities are the inevitable consequence of the profound adjustments required by war and impose difficult burdens upon some banks as well as on numerous other types of businesses.

Viewing the banks as a whole, however, earnings are increasing. While it is difficult to forecast all of the factors involved—such as the rate of return on Governments acquired, the changes in other sources of earnings, future expenses and charge-offs, recoveries, and taxes—we estimate that profits will increase sufficiently to cover increased taxes and that net profits after taxes for the banks as a whole will continue to range between $400,000,000 and $500,000,000. Thus the increased taxes of the banks will be paid for out of increased earnings rather than reduced profits.

I have here another chart (chart E) which shows for national banks since 1890 and for insured commercial banks since 1934, the amount of profits, after taxes, earned on each $100 of total capital accounts, i. e., capital, surplus, undivided profis, and reserves. The figures for 1942 are estimates, while those for 1943, 1944, and 1945 probably should be called guesstimates. Supporting figures are presented in table 5. The point of the chart is readily apparent. The banks can and, in the future, will be able to pay the present rate of assessment.

Summary and conclusion.—We support the proposal to exempt the war-loan deposit from insurance assessment, solely as a war measure, in our desire to facilitate the Treasury's war financing. We consider inadvisable any other exemption, and any reduction in the rate of assessment at this time.

We face an unknown future. If past experience is any guide we can anticipate that in the post-war future American banking will face the most critical period of its entire existence. While there are comforting elements of strength in our situation we must not close our eyes to those elements of weakness which may arise.

TABLE 5.—*Net profits per $100 of total capital accounts, national banks, 1890–1941*[1]—*Insured commercial banks, 1934–45*[2]

Year	National banks	Insured commercial banks	Year	National banks	Insured commercial banks
1890	$7.70		1918	$9.89	
1891	7.68		1919	10.44	
1892	6.59		1920	9.97	
1893	6.69		1921	6.48	
1894	4.19		1922	7.39	
1895	4.75		1923	6.73	
1896	5.06		1924	7.36	
1897	4.60		1925	8.22	
1898	5.24		1926	7.96	
1899	5.73		1927	7.91	
1900	8.62		1928	8.21	
1901	7.70		1929	7.78	
1902	9.00		1930	4.04	
1903	8.55		1931	−1.45	
1904	8.37		1932	−4.96	
1905	7.53		1933	−9.60	
1906	8.55		1934	−5.15	−$5.49
1907	9.49		1935	5.14	3.35
1908	7.87		1936	9.98	8.35
1909	7.52		1937	7.11	5.97
1910	8.33		1938	6.05	4.68
1911	8.12		1939	7.44	5.99
1912	7.51		1940	6.97	6.08
1913	7.87		1941	7.49	6.72
1914	7.28		1942		[3] 5.87
1915	6.04		1943		[3] 5.61
1916	7.90		1944		[3] 6.12
1917	9.12		1945		[3] 6.84

[1] For 1890–1915, net profits are for fiscal years and total capital accounts are as of June 30 or nearest available date; for 1916, net profits are for 18-month period ended Dec. 31, 1916, adjusted to an annual basis, and total capital accounts are averages of figures for June 30, 1915, June 30, 1916, and Dec. 31, 1916; for 1917–41, net profits are for calendar years, and total capital accounts are averages of figures for call dates during the year.

[2] For 1934–41, net profits are for calendar years and total capital accounts are averages of figures for beginning, middle, and end of year.

[3] Estimated.

One of the principal bulwarks of depositors' confidence is the deposit insurance system. Confidence in the banking system will be maintained so long as bank customers believe that the banks are kept sound through good management and supervision, and so long as they believe that the Federal Deposit Insurance Corporation is financially sound and properly administered. Loss of confidence would inevitably lead to hoarding on a scale greater than anything we have ever imagined, and to a deterioration in the banking structure of such a character as to require direct financial intervention of the Federal Government. Amid the popular outcry that would accompany such developments what would be the prospects for continuance of a system of privately owned banks which had claimed to be unable to support financially a deposit insurance system and had not made adequate provision for the risks of doing business although it had a record of sustained earnings and profits even after increased taxes?

Continuance of a system of privately owned banks is essential to the maintenance of the private business system which has contributed so much to the greatness of this country. The preservation of our banking system calls for wholehearted and intelligent participation in the war effort, for conservation of earnings and provision out of current earnings for losses, for strengthening of capital whenever possible, for farsightedness on the part of bankers and public officials concerned with banking, and for the maintenance of the Federal Deposit Insurance Corporation in as strong a financial position as possible. Not until we have completed our major post-war adjustments and have arrived at a comparatively stable post-war economy should we consider any reduction in the assessment rate or any further exemption of types of deposits from assessments.

The CHAIRMAN. Does any Senator desire to question Mr. Crowley?

Senator BARKLEY. Let me ask you this, Mr. Crowley: Suppose that a given bank had $2,000,000 on deposit, from customers' deposits in the bank, and suppose that the depositors bought through the bank $400,000 of Government bonds. Now, that is probably a high figure, but we will just use that as an illustration.

The effect of this bill would be that the $400,000 would be deducted from the $2,000,000, upon which you would assess one-twelfth of 1 percent to form the capital for the discharge of the duties of the F. D. I. C.?

Mr. CROWLEY. That is correct, Senator. The war loan deposit account would be deducted from total deposits. The $400,000 would be taken out of the customers' accounts, and credited to the war loan deposit account, which is the Treasury's account. Our assessment would be levied upon the total of the customers' accounts but not on the Treasury's war loan deposit account.

Senator BARKLEY. Yes.

The CHAIRMAN. That is, if this bill passed.

Mr. CROWLEY. That is right.

Senator BARKLEY. In the event such a bank should close, who would be obligated to pay?

Mr. CROWLEY. That would be a secured account, so the Treasury would not suffer any loss; in other words, it would be an agency account. If there were any loss the F. D. I. C. would pay, up to $5,000.

Senator BARKLEY. About what percentage of deposits, total deposits of any given bank, over a period of a year, are used for the purchase of bonds?

Mr. CROWLEY. That is difficult to answer, Senator. We can give you the picture as of the present time. What is the percentage of bonds in the insured banks now? Mr. Eccles, you must have that.

Mr. ECCLES. I don't know that I have it for the insured banks. It would be all banks. It changes so rapidly. I would say that it would be between 40 and 50 percent.

Senator BARKLEY. Of the deposits?

Mr. ECCLES. Forty to fifty percent of the total resources of the banks are represented by Government bonds.

Senator BARKLEY. Well, that is of the total resources of the banks.

Mr. ECCLES. Well, about the only other resources would be capital and surplus.

Senator BARKLEY. That would not include the deposits of the people. That is a liability.

Mr. ECCLES. Capital and surplus is only about 5 or 6 percent of the total anyway; such a small part.

Senator BARKLEY. Well, I imagine it would be a rather high estimate to assume that in any given bank 40 to 50 or even 25 percent of all deposits would find their way into Government bonds.

Mr. CROWLEY. It would depend upon circumstances, Senator. We estimate that most of the growth in bank deposits and assets over the next few years will result from bank purchases of Government securities and that those purchases will amount to about 20 or 25 billion dollars under present conditions. We have no idea as to the extent to which individuals and business firms will invest their existing deposits in Government bonds.

Senator TOBEY. Mr. Crowley, the old building and loan associations, in some States, particularly New England, have become federalized, have they not, under the F. D. I. C. system?

Mr. CROWLEY. No, Senator; they are under the home-loan bank insurance fund.

Senator TOBEY. I see.

Mr. CROWLEY. We only have commercial banks, Senator, and some mutual savings banks.

Senator TOBEY. Up in our New England end of it the States form their own insurance companies.

Mr. CROWLEY. That is correct, up in your country.

Senator TOBEY. Your application as to savings banks is more to the West and South, is it?

Mr. CROWLEY. No; we have quite a few in New York. We have perhaps one billion and a half of deposits in insured mutual savings banks in the city of New York, the larger ones. Mutual savings banks in Philadelphia, New Hampshire, and Vermont as well as banks elsewhere have become insured with us. But, you people have gone along with your State funds.

Senator TOBEY. Yes.

Senator DANAHER. Mr. Crowley.

Mr. CROWLEY. Yes, Senator.

Senator DANAHER. As I read the bill, S. 700, it says, "any balance payable to the United States by any insured bank" shall constitute part of the determination of the assessment base under the present law.

Mr. CROWLEY. That is correct.

Senator DANAHER. But if that balance be devoted to the acquisition of United States Government securities under the Second Liberty Bond Act, the amount so invested will be excluded from the assessment base.

Mr. CROWLEY. Yes.

Senator DANAHER. And it does no more than that?

Mr. CROWLEY. That is right. It does not eliminate the regular, general account or the several accounts that the Government might have in the banks; just those particular war-loan accounts.

Senator DANAHER. And that applies only to the definition of "deposit" as it appears in section 12C of the act.

Mr. CROWLEY. That is correct, Senator.

Senator DANAHER. The only other change suggested by the bill, then, applies with reference to the extension of the period within which this act will be operative?

Mr. CROWLEY. That is correct, Senator.

The CHAIRMAN. For the duration of the war and 6 months thereafter; right?

Mr. CROWLEY. That is correct, Senator.

Senator BARKLEY. Suppose a person wants to buy bonds through the bank and has no deposit of his own there, but gives a check on another bank for the cost of the bonds, would the amount of that go into this fund in the bank to which the check was given?

Mr. CROWLEY. Yes, sir; that is correct.

Senator BARKLEY. Suppose I went into the bank and put up, say, a thousand-dollars for the purchase of a bond, would that $1,000 go into this fund?

Mr. CROWLEY. Yes, sir; it would.

Senator BARKLEY. I suppose that is a rank supposition.

Senator TOBEY. I thought you were pretty modest.

Senator RADCLIFFE. This would reduce your assessment basis nearly one-half; is that the idea?

Mr. CROWLEY. Oh, no, Senator. This would only reduce our income about 2½ million dollars as compared to an income that we will have of upwards of $70,000,000 in 1943. It would give up about 5 percent of our income.

Senator BARKLEY. Well, that means on the average, then, only about 5 percent of the deposits will be in the Treasury's war loan deposit account and used for payment of bonds.

Mr. CROWLEY. You understand, Senator, that this will be done, perhaps, every 3 or 4 months; whenever the Treasury renewed its financing, you see.

Senator BARKLEY. Does this apply to the Defense bonds as well as to the big bond issues such as were put on the market a month or so ago?

Mr. CROWLEY. That is correct, Senator. It would apply to any payment for any bond made through the banks and credited to the Treasury's war loan deposit account. What issues would be paid for in this manner would be determined by the Treasury.

Senator BARKLEY. As to the day by day purchases of Defense bonds, would it apply to those?

Mr. CROWLEY. No, sir. You mean where they are carrying on the ordinary transactions out of your account?

Senator BARKLEY. Yes. For instance, would it have any effect at all on pay-roll deposits?

Mr. CROWLEY. No, sir; that does not go into this account.

Senator BARKLEY. Or withholdings?

Mr. CROWLEY. No, sir.

Senator BARKLEY. Or the 10 percent pay-roll bond contribution?

Mr. CROWLEY. No. That does not go into this account.

Senator RADCLIFFE. Mr. Crowley, you used a percentage, 40 percent, a while ago, and I did not quite understand in what sense you used it.

Mr. THOMPSON. Those are the actual holdings in banks of Government securities. Those are not related to war loan accounts.

Mr. CROWLEY. That runs about 40 to 50 percent of the deposit liability.

Mr. THOMPSON. Yes, sir.

Mr. CROWLEY. In other words, 40 percent of those assets are invested now in Government securities.

Senator DANAHER. Mr. Crowley, what would be the aggregate of the United States securities in which the insured banks will be permitted to participate under this program; in other words, to what extent are we actually going to help the Federal Reserve, and hence the Government.

Mr. CROWLEY. What percentage, Mr. Eccles, do you think the banks would participate in?

Mr. ECCLES. Of course, this bill has nothing to do with that, and as to the extent that the banks will have to buy Government securities, that will depend upon the amount of tax revenue. Of course, it will depend upon the amount of money Congress appropriates; secondly, it will depend upon the amount of taxes you will raise.

Now, the difference between what you appropriate and the taxes you raise, is going to have to be borrowed. If you can borrow all of it from the public, you will have to borrow none of it from the banks. To the extent you do not get it all from the public, you will have to get the balance from the banks.

83118—43——3

Now, if it is going to be based upon our experience during the past year, we had to borrow in the year 1942 pretty close to half of all that was borrowed; that is, half had to be borrowed from the banks.

Now, that should be reduced. That is very inflationary, because every time the banks loan money for financing, they create new money; in other words, deposits are created by bank loans, whether it is on Government bonds or any other security. That is where your inflation comes from. It is through the bank's purchases of Government securities, and that is the last way we want to do business, financing.

Senator DANAHER. Mr. Eccles, if I have not actually put over to you the point I had in mind, it is due to my own imperfect understanding of the situation, I am sure. But as I read this bill, we are relieving from the assessment base so much of the balance as otherwise would be used to calculate the amounts of F. D. I. C. premiuns owed to the United States and will be invested in United States securities; isn't that correct?

Mr. ECCLES. Yes; that is right.

Senator DANAHER. Now, then, how much in total would be available for investment in that respect?

Mr. ECCLES. You mean, how much would a bank have available to invest in United States securities?

Senator DANAHER. Not any bank; the aggregate. Mr. Crowley says we are simply going to lose $2,000,000 in revenue.

Mr. CROWLEY Two and one-half million is right

Senator DANAHER. In this very particular I do not quarrel with that; I believe it is a desirable thing. But in arriving at the $2,000,000 loss of premium income, it is obvious that he has to have a computation of what those balances amount to, which otherwise would be used as part of the assessment base.

Mr. ECCLES. The Treasury determines what those balances are going to be. The Treasury determines that because the Treasury draws down the balances as they expend the money from the war loan account.

I do not want to go into that now. Maybe Mr. Crowley should finish first. I have a statement on this aspect of the problem which does get into the question of reserves, and into the question of war-loan accounts, as such. There is a twilight zone. However, I will take on the question if you want me to now.

The CHAIRMAN. Wouldn't it be better to wait until Mr. Crowley finishes?

Senator DANAHER. Perhaps your statement will answer what I am after, but if you do have it now, that specific figure, I would appreciate it.

Mr. CROWLEY. It is an average deposit of about $3,000,000,000, the best we can estimate, and we have a chart prepared on that. Have you got your chart there, Mr. Thompson?

Mr. THOMPSON. Yes, sir.

Senator DANAHER. About 3 billion, Mr. Crowley?

Mr. CROWLEY. Three billion; yes, Senator. We have a chart on that.

Mr. THOMPSON. This chart shows the monthly borrowings of the Treasury with the war-loan deposit of banks. You will see that the two curves in 1941 and 1942 ran approximately together. The scale for the Treasury borrowings is double the scale for the war-loan deposits, and from that we reach the conclusion that the war loan deposits in the banks will average about one-half of the average total borrowings of the Treasury, whether from the banks or from the public. With nearly 2 billions of Government borrowings monthly and about 9 billions each quarter, we estimate that the war loan deposits will average about 3 billions. If borrowings increase the war loan deposits will increase, and the assessment will increase correspondingly.

Mr. CROWLEY. And that is all based upon the theory that we can spread this out to a number of insured banks throughout the country.

Senator DANAHER. Mr. Crowley, when you say it proceeds on the theory that you can spread it out, will you be able, through some peremptory demand, to insist that it be prorated among them?

Mr. CROWLEY. Of course, our table shows, Senator, if the assessment is eliminated, that this should be a very profitable account to the banks. And, assuming that they are in operation for profit, they should be willing to take on this account and to cooperate with us; 5,600 banks have already qualified with the Treasury for these accounts.

Senator TOBEY. That is a fair assumption, isn't it?

Mr. CROWLEY. That is right. We anticipate that this money is worth about eleven-twelfths of 1 percent net to them.

Senator SCRUGHAM. Mr. Crowley, I have briefly discussed the matter with you, but in the State of Nevada there are two State banks, or one large State bank and a branch, thoroughly sound institutions, largely owned by local capital, that have been refused benefits of Federal deposit insurance.

I would like to ask the reason, as a matter of record, and also what remedy you propose which would make them eligible for Federal Deposit insurance.

Mr. CROWLEY. Senator, there is one thing that I did not quite understand. You say that they were locally owned?

Senator SCRUGHAM. To a large degree.

Mr. CROWLEY. Well, I presume you are talking about Las Vegas and Boulder City.

Senator SCRUGHAM. Yes; and the branch at Boulder City.

Mr. CROWLEY. Well, from my understanding, our record shows in connection with that bank that all except qualifying shares are not owned locally, and that the qualifying shares that the directors have are under option by a holding company, to be purchased from them at their option at a fixed purchase price.

Senator SCRUGHAM. I understand the outstanding shares are optioned.

Mr. CROWLEY. That is a subject, gentlemen, that would take a long, long time to explore, and we do not like to have that brought up in connection with this bill.

I am sure that our Corporation, our associates, in the Federal supervisory and the regulatory fields would welcome an opportunity, if the Senate Banking and Currency Committee so wished, to be given a reasonable length of time to submit our reasons for the stand we have all taken on the expansion of holding company banks throughout the west coast.

I think, Senator, as far as your situation is concerned, that if those people will buy the controlling interest in that bank, which they have indicated a willingness to do, that we would be very happy to insure it. I hate to have that tied onto this bill, but I want you to know, Senator, that we would be very happy to sit down and discuss this matter with you.

This has been kind of a thorn in our sides for a long, long time, and we feel quite definite about it, since all of the supervisory forces and the S. E. C. are in accord, and if this committee has any requests we would be glad to prepare our testimony and our charts and show you why we have taken the stand we have taken on that matter.

The CHAIRMAN. Well, we can take that up at another time.

Senator SCRUGHAM. Yes; but the point I wish to register at this time, there is apparent discrimination against one area and one group, and I naturally make strong objection, particularly to one fact, that the institutions are intact and they are very sound.

Mr. CROWLEY. I think you would find, Senator, if you knew our whole picture, and I am sure this committee would agree with us, that our program has been very constructive, and we have treated everyone very fairly, and I am sure we are carrying out the intent of Congress in the history of banking legislation over a period of 25 years.

Senator SCRUGHAM. Since this, perhaps, as Mr. Crowley suggested, is not the time to discuss this further, I will withdraw my request for the statement on the record.

The CHAIRMAN. All right. Are there any other questions?

Senator SCRUGHAM. Nothing further, Mr. Chairman.

The CHAIRMAN. This is sort of a concluding question I was going to ask. To eliminate the one-twelfth of 1 percent on the so-called war-bond loans will aid the Government, you say?

Mr. CROWLEY. I think so, Senator.

The CHAIRMAN. And not in any way injure the F. D. I. C.?

Mr. CROWLEY. For the duration of the war, that is correct, Senator, we think that.

Senator BARKLEY. In other words, the revenue that the F. D. I. C. is now getting out of this fund, that would be withdrawn from that revenue under this bill, is not needed by the F. D. I. C.?

Mr. CROWLEY. Well, it might be needed, but we do not think that it will hurt us to give it up for the duration of the war. Naturally, we could put into use all of the surplus, or all of the income we could get, but so long as it is not a permanent reduction and is not used as a precedent for other deductions we do not think it will be harmful to us, and we recommend its passage.

The CHAIRMAN. These deposits do not last very long in a bank, do they?

Mr. CROWLEY. About 60 to 90 days, Senator, and they begin to flow out.

The CHAIRMAN. They would probably not be of much aid to the bank anyhow.

Mr. CROWLEY. Well, there would be new funds coming in to take care of the funds going out, assuming the Treasury would need the financing.

The CHAIRMAN. You think it would result in more banks cooperating in the handling of war loan deposit accounts?

Mr. CROWLEY. I do think so, Senator.

The CHAIRMAN. Thank you very much.

STATEMENT OF MARRINER S. ECCLES, CHAIRMAN, FEDERAL RESERVE BOARD, WASHINGTON, D. C.

The CHAIRMAN. You deal primarily with the reserve requirements, I take it, in this bill?

Mr. ECCLES. Mr. Chairman, and members of the committee, I have a statement here which is not very long, that I thought for the purpose of the record I might read.

The CHAIRMAN. Would you rather read it uninterruptedly?

Mr. ECCLES. If I could, and then take the act as a basis for such questions as might arise.

The CHAIRMAN. All right.

Mr. ECCLES. This measure provides that for the duration of the war and 6 months thereafter so-called war-loan deposit accounts shall be relieved from Federal deposit-insurance assessments and from reserve requirements. Its enactment will help to perfect the machinery for, and thus facilitiate and make smoother, the Government's war-financing operations.

I should like to state as simply as I can what the bill does and why its enactment is important at this time. It is not a complex matter, and I see no reason why it should arouse controversy. The bill has the approval of the Treasury, the Federal Deposit Insurance Corporation, the Board of Governors, and the Federal Reserve System, and the System's Open Market Committee.

As members of the Senate committee will recall, war-loan accounts were originally anthorized by the Liberty Loan Acts as amended. This act provides that the Secretary of the Treasury may deposit—

> in such incorporated banks and trust companies as he may designate, the proceeds or any part thereof, arising from the sale of the bonds and certificates of indebtedness, Treasury bills and war savings certificates authorized by this Act * * *

Incorporated banks and trust companies may qualify for war-loan accounts by applying to the Treasury through the Federal Reserve banks. Such accounts are fully secured by a pledge of assets for a stipulated amount which is the maximum that may be on deposit in the account at any one time.

When banks which have qualified for war-loan accounts subscribe to Government securities for their customers or themselves, they enter the amount of their allotted subscriptions in the war-loan accounts on the payment dates and subject to call by the Treasury. Subsequently, as the Treasury has need for funds, a call is issued; that is, notice is given to these banks to transfer to their respective Federal Reserve banks whatever percentage of the funds in the war-loan accounts is required by the Treasury to meet its current expenditures.

Senator TOBEY. Is that appropriated from all banks, or is there some appropriation from all banks?

Mr. ECCLES. It is entirely up to the bank on the basis of its application. You mean the withdrawal?

Senator TOBEY. The same percentage right on through?

Mr. ECCLES. Yes, sir.

Senator TOBEY. Not regarding the size of the bank, though.

Mr. ECCLES. Well, they do not have to do that. That is what they have been doing.

Senator TOBEY. That is the custom?

Mr. ECCLES. There is some thought that they may work out a different program from that, I understand, but it is prorated at the present time.

Thus the war-loan accounts are drawn down gradually as Treasury needs arise; the money is checked out of the Reserve banks by the Treasury and ultimately flows back again to the banking system as deposits.

The Treasury does not check against its account in individual banks. All it does is to have these transfers made to its account with the Federal Reserve banks. The Federal Reserve System being just the fiscal agent, and all payments made by the Treasury are against its account in the Federal Reserve banks.

Those accounts are kept down as much as possible. They just keep feeding into those accounts as the Treasury needs the money, so that the maximum amount of funds is kept within the private system.

If there were no such mechanism—if all banks in subscribing to Government securities for their customers or themselves were to transfer the funds immediately to the Reserve banks—there would be periodic heavy drains on the deposit totals of the banking system, with seriously disruptive effects on the economy, particularly on the Government bond market. The larger the financing operation, the greater and more disruptive the drain would be. In peacetimes when the Government was not compelled to raise and expend such huge sums as are demanded by the war and when banks had superabundant reserves, the situation was very different. But today when the Treasury must go to the public and to the money market for large sums of money every few months, and when reserves are rapidly absorbed as currency in circulation expands and bank deposits increase, it is very important to extend the war-loan-deposit mechanism as widely as possible throughout the banking system.

If there were no such mechanism, it would be necessary to pump billions of reserves into the banking system to offset the heavy drains at financing periods and thus prevent widespread liquidation with the disturbance this would cause in the bond market. Then as the funds were spent by the Government and flowed back into bank deposits, the reserves that had been pumped in would be excessive relative to the current need. Any such alternating scarcity and redundancy of reserve funds would create difficult problems for the Treasury and the Reserve System.

To the extent that the war-loan account mechanism exists throughout the banking system, such difficulties can be avoided and the flow of deposit resources into the war-loan accounts, then to the Reserve banks as the Treasury needs and calls for the money, then back into the banking system as the Treasury expends the money, is accomplished smoothly and without disruptive effects. There is a close adjustment and a minimum time lag between the drawing down of the money and its flow back into the deposit structure.

Because of these considerations, the Reserve System has made a special effort and a concerted drive through all of the Reserve banks to induce as many banks as possible to apply and qualify for war-loan deposit accounts. The results so far have been gratifying, and a large number of banks, even though they may have felt that the war-loan accounts should not be subject to deposit-insurance assessments or to reserve requirements, have applied and qualified. There are still many thousands of banks which have not yet come in, and it is clear that the requirements of existing law, which this bill would suspend for the duration, are a real deterrent in many instances. Not only is a more widespread setting up of this convenient and necessary mechanism thus impeded, but banks that have war-loan accounts are discouraged from utilizing them as fully as would be the case if these statutory requirements were suspended. Neither requirement existed when war-loan accounts were originally authorized by Congress in the last war. We had no deposit insurance at that time and war-loan accounts were not subject to reserve requirements before 1935.

I hope that this measure will be promptly enacted so that the mechanism, which I have tried to outline very simply, may be as widely set up and as generally utilized as possible to facilitate the large financing operations which are ahead of us as long as the heavy requirements of the war situation continue.

The time element seems to me is very important, so that should there be large financing operations in April, which has been in contemplation, the problem of financing would be greatly increased unless this bill is enacted in the meantime, and we are successful in increasing and expanding war loan accounts.

Now, I will be glad to answer any questions, or to explain more fully this mechanism, if the statement I have made does not do so.

The CHAIRMAN. What are the requirements, the reserve requirements? Is it 3 percent on deposits, on time deposits?

Mr. ECCLES. It is 6 percent on time deposits. The statutory requirement is 3. The Reserve Board has the power to double reserve requirements, and the reserve requirements were doubled some time ago, so that they are 6 percent on time deposits. They are now 14 percent on what we call country bank classifications on demand deposits, and they are 20 percent on demand deposits of Reserve city banks and central Reserve city banks.

As to the central Reserve city banks, the statutory amount is 13 percent. We had power to double that, and we did, to 26 percent. It was reduced this last fall to 20 percent, which is the same percentage of reserve requirements as required for the Reserve city banks.

You see, we have three classes of banks: country banks, Reserve city banks, and central Reserve city banks. The only central Reserve cities are New York and Chicago.

The CHAIRMAN. Your opinion is that these war-loan deposits would increase?

Mr. ECCLES. Yes.

The CHAIRMAN. As to which the number of banks would increase.

Mr. ECCLES. The number of banks that would be willing to open war loan accounts I am sure would greatly increase. The banks which now have war-loan accounts and qualify only for limited amounts would increase the amount that they were qualified to carry, so that this would help in two ways.

The accounts are not necessarily profitable to the banks. The way it is at the present time, many of them feel that the accounts are actually a loss to them; that they pay deposit insurance assessments of one-twelfth of 1 percent on the account, and if they have excess reserves or they have idle balances with the Federal Reserve, they would sooner remit the funds that are withdrawn from them to the Federal Reserve against their account than pay one-twelfth of 1 percent for the privilege of keeping that account.

Now, that is the way a lot of them feel about it, because they say they cannot invest those funds for the short period of time that they may have them. It is uncertain, or, at least, they are uncertain as to how long the funds are going to be with them. They know that the funds are going to be with them only for a short period, and are subject to withdrawal any time. Therefore the only opportunity that they have to invest those funds at a profit would be in a very short term Government obligation.

They could invest the funds in bills, which is a three-eighths market. As the funds were drawn down, they could sell their bills to the Reserve banks at three-eighths, under the established rate for bills.

But, many of the smaller banks just do not want to be bothered about doing that. It is a question of putting bids in for bills for a few days, for the short period that they think they may have the funds in the war-loan account. It is a real deterrent to have to pay one-twelfth of 1 percent.

Senator DANAHER. I think that is nearer actually a net one-fourth of 1 percent than eleven-twelfths of 1 percent, on that basis.

Mr. ECCLES. I do not know how Mr. Crowley got eleven-twelfths, because a bank has no chance whatever to make earnings on these accounts, unless they invest this fund in securities that they could immediately sell as the funds are withdrawn.

Now, it may be they could invest in a long-term bond today, and that they could sell it in a week at what they paid for it, but there is the brokerage that they pay for buying and the cost of selling it which would, no doubt, absorb the interest, and then there is always the question ot fluctuation of a few thirty-seconds, which would not only wipe out their interest, but probably would mean actually losing money, so that they won't put out these funds in long-term paper.

Now, they could put the funds into short-term paper that is immediately available at a fixed rate of return, such as the bills which the Federal Reserve stands ready to buy at three-eighths, but there is never the assurance that they can buy the bills at three-eighths, because the way they get the bills would be to put bids in.

Every week the Treasury offers bills. The amount offered is, say, $700,000,000, 90-day bills. Now, those bills go to the highest bidder. The market is very close to three-eights. But, the way the situation has been, it is difficult to get a lot of these little banks to put bids in for bills. They do not understand the mechanism. They do not want to be bothered with it.

If they could be forgiven the one-twelfth of 1 percent, which it costs them now, I am sure that the banks would open up more war loan accounts. The bigger banks, as well as some of the small banks, the banks in the money market, keep those funds pretty well invested in bills, and thus they make their three-eighths in bills.

Senator DANAHER. In view of the fact that that operation will have such a stabilizing influence, as you describe, shouldn't we make it more attractive somehow, or does any device suggest itself to you to make it more attractive?

Mr. ECCLES. No; I think this will make it sufficiently attractive in practically all the banks. So far as bank resources are concerned, I think that we would get in possibly anywhere from 80 to 90 percent of all of the banks; if not in number, then on the basis of reserves.

Senator DANAHER. I tried to capitalize the premium income that Mr. Crowley suggested will be lost to F. D. I. C., and it will aggregate apparently about $2,400,000,000 that will be available in this way.

Mr. ECCLES. I believe that is theoretical.

Senator DANAHER. Yes; but it is substantially in line with what Mr. Crowley is talking about there.

Mr. ECCLES. I think that is correct. I think it is correct in this sense: I do not believe that the F. D. I. C. actually loses this income, because if this sort of a bill is not passed, the deposits will not be in the banks upon which to base the assessment. You lose this income on the basis of the assessment on the assumption that the banks will open all of these war loan accounts, whether you pass this bill or not.

Now, if you do not pass the bill, and you do not have the war loan accounts, then the F. D. I. C. loses the income anyway.

Mr. CROWLEY. However, that money, while it may not only be in 5,000 banks, the total amount of money would be in 5,000 banks instead of 14,000.

Mr. ECCLES. I think there is no question but what there will be some war-loan accounts whether the bill is passed or not, and to that extent you would lose revenue.

I do think, however, that there will be more war-loan accounts if this is done, and if there are more war-loan accounts it means there are more deposits in the banks by reason of this action, so that it does not mean, it seems to me, that this is actually going to reduce the deposits of the banks by the amount that might be apparent, because some of the deposits in the war-loan account will be deposited that otherwise would not be.

Senator DANAHER. In any case, it is an accommodation to the Government to accomplish this.

Mr. ECCLES. It is an accommodation to the Government, and it is a great help, I would say, to the banking system as a whole; not from the standpoint of its earnings, but it is a great help in that it stabilizes the whole security market and stabilizes the total deposit structure and the flow of funds.

Now, just assume that you go out throughout the country to sell a very large amount of securities outside of the banks. I am not talking now about what you would sell to the banks, because that is a different matter. But say you sell $10,000,000,000 worth of securities outside of the banks, and there were no war-loan accounts, that $10,000,000,000 would be drawn from the banks of this country, and would come right out of the community and flow into the Federal Reserve to the credit of the Government.

Now, that 10,000,000,000 withdrawal would not only wipe out completely the banks' 2,000,000,000 or so of excess reserves, but would create a deficiency of $8,000,000,000, approximately, and the banks would be forced either to borrow that amount from the Federal Reserve or they would be forced to sell Government securities to offset the withdrawal. Otherwise the Federal Reserve System would be forced to go out and assist, by buying Government securities to replace the withdrawal.

Then, as the Government spent this money and it went back to the banks again, they would be right back where they were before, approximately. The deposits would go up again in total, and reserves would likewise go up. Now, that, of course, would be anything but a smooth operation.

You can all see that it is desirable that the money in a community that goes into Government bonds should only be drawn out of the banks of the community about as fast as the Government is spending the money. In other words, if the Government has 10 billion on deposit in war-loan accounts in the banks of the country, and it draws it down a few hundred million at a time; we will say it draws it down a few hundred million a week, meeting its weekly requirements, this would mean that the money was being put back into the banks of the country about as fast as it was drawn out, so that although the war-loan accounts go down, the accounts of individuals and corporations go up to offset it. So far as the banking system as a whole is concerned, there would be no appreciable change in the total amount of deposits and reserves. This makes it possible for the Open Market Committee to stabilize the money market situation which otherwise just could not be done now on the size of the financing we have.

Without the war loan account mechanism, with its effect on stabilizing the money market, it would be practically impossible to do the financing on this scale.

Senator TOBEY. Mr. Eccles, I assume with the imminence of inflation, as real as it is, that the F. D. I. C., the Treasury, and your group are integrated pretty well in considering the whole picture, are you not?

Mr. ECCLES. Well, I would not say that we are integrated at all, so far as inflation is concerned, because the problem of inflation is something that the F. D. I. C. and the Federal Reserve and the S. E. C. can do very little about.

Senator TOBEY. Well, the S. E. C. apparently had something in mind when it put out its recent memorandum.

Mr. ECCLES. Well, all the S. E. C. can do would be to deal with the stock market.

Senator TOBEY. Yes; that is one effect.

Mr. ECCLES. Yes.

Senator TOBEY. But does not the Federal Reserve and the Treasury confer on these matters, on the question of inflation?

Mr. ECCLES. Not on the question of inflation.

Senator TOBEY. Not at all?

Mr. ECCLES. The question of inflation is the problem, pretty largely, it seems to me, of Congress. You would have no inflation if you collected from the people as a whole the amount the Government is spending.

Senator TOBEY. Which we cannot do.

Mr. ECCLES. Even if you did not collect the amount you are spending, if you had idle men and idle facilities, you would still have no inflation. You could not have. Inflation is merely a condition where the demand for goods exceeds the supply.

Senator TOBEY. And the purchasing power is greater than the supply.

Mr. ECCLES. If you had a large number of unemployed people and idle facilities, you would not create inflation, because increasing the purchasing power by Government spending would result in expanding production. But when you reach a point such as we have now, where the expenditures of Government so far exceed its receipts, and the supply of manpower and goods available is so much less than the purchasing power, the result is an inflationary situation that neither the Treasury nor the Federal Reserve nor the S. E. C. can do anything about. The only way you can deal with the inflation problem is to stop the expansion of income at the source. Then you would not have to take so much of it back in taxes, or you would not have to sell so many securities to the public. In other words, if farm income and labor income, salaries and other income, had not been so greatly expanded over the last 2 years, the problem would not be so acute.

But purchasing power has been expanded far beyond the supply of goods available, so that it means that you have either got to put on taxes to reduce purchasing power, or you have got to sell Government securities in a sufficient amount to absorb it.

Now, we are doing neither sufficiently, and we have a terrific gap. We have a gap of purchasing power this year between the anticipated supply of goods available and the money available, spendable income, of about $40,000,000,000.

Senator TOBEY. What was that figure again, please?

Mr. ECCLES. $40,000,000,000 is your gap.

You are either going to have to get that 40 billion in taxes, and that is above your last year's revenue bill, or you are going to have to get it in selling securities to the public to the extent of 40 billion, or you are going to get it in both, and to the extent you do not get it either in taxes or by selling securities to the public, then you have got that much money pressing on the short supply of goods, and that is why you are having to ration everything. That is why you are having black markets, and violations on your ceiling prices.

Because you do not get it back in taxes, or you do not borrow it back from the public, the Federal Reserve System is having to supply an increasing amount of reserves to the banks, so that the banks can create money to finance the war. And, we are actually creating new money at the rate of around $3,000,000,000 a month. That is the average rate at which we are actually creating new money today because of the failure to get back in taxes, or to sell to the public the amount necessary to absorb this inflated income that has been created.

Now, that is your picture. I want to say this: So far as the Federal Reserve System is concerned and so far as the F. D. I. C. and the S. E. C. and the Treasury are concerned, except for what influence they have on the tax picture, there is little that we can do to prevent run-away inflation. The thing is entirely in the hands of Congress with reference to factors of enforced savings and other controls that would tend to alleviate this situation.

Senator TOBEY. Every statement you are making here now as to what can be done to meet this economic and financial condition strengthens the thought we had ourselves, and if given to the country as a whole could be very helpful.

Mr. ECCLES. Senator, I have been making those speeches for 2 years.

Senator TOBEY. Where? Through what agencies?

Mr. ECCLES. I gave them publicly.

Senator TOBEY. Did you ever make it known over the broadcasting stations at all?

Mr. ECCLES. Yes, sir; I did.

Senator TOBEY. I wish I had heard that. On the Treasury bills that Mr. Morgenthau released recently and put in circulation, were you the party who suggested it?

Mr. ECCLES. Yes, sir.

Senator TOBEY. The Federal Reserve notes?

Mr. ECCLES. We not only suggested it, but initiated it.

Senator TOBEY. You suggested it?

Mr. ECCLES. We take the responsibility for it.

Senator TOBEY. All right. What do you say to the thesis that that is inflationary?

Mr. ECCLES. Well, I would like to discuss that. As to the question of reserve notes——

Senator DANAHER. Pardon me, if you want it to be discussed, there is a question of definition. Senator Tobey said "Treasury bills" and then said "Federal Reserve notes," and I think you are both speaking about Federal Reserve bank notes.

Senator TOBEY. Yes.

Mr. ECCLES. I possibly should have corrected you, or you should have corrected me, Federal Reserve bank notes—$660,000,000 of notes recently have been put in circulation.

Senator TOBEY. That were put in the pigeon-hole, passed off and then put out.

Mr. ECCLES. I think it is purely academic. Theoretically it is inflationary, but so is the borrowing to finance the war from the banks instead of from the public inflationary.

Senator TOBEY. Are you very concerned over the danger of inflation?

Mr. ECCLES. I am very much concerned and I have been very much concerned.

Senator TOBEY. We have been moving toward it, haven't we, rather steadily?

Mr. ECCLES. I have been very much concerned for at least 2 years about it.

Senator TOBEY. And we are moving steadily toward it, are we not?

Mr. ECCLES. We are.

Senator TOBEY. And the chances are—if this is not a fair question, do not answer it—the chances are inflation cannot be escaped in this country, isn't that true to a degree?

Mr. ECCLES. Of course, one must define what you mean by "inflation." We had inflation after the last war, of about 100 percent.

Senator TOBEY. Yes.

Mr. ECCLES. Now, we have not yet had any such inflation in this war. The increase in the cost of living since 1941 is less than 25 percent, so that after all the measure of inflation is the measure of the index in the cost of living from some base; in other words, it is a measure of what your money will buy.

Certainly, the purchasing power of money is diminishing, and has been diminishing. It has not diminished seriously yet. It might well diminish further.

Certainly, if we do not get more in taxes, or in some form of post defense credit; if we do not sell more seucurities to the public and less to the banks; if we do not hold down the purchasing power of the people, if we keep expanding it, why, the pressures for inflation, the dangers of inflation greatly increase.

Senator TOBEY. Yes. Has installment buying of these new Government bonds been put into effect, as it was in the last war?

Mr. ECCLES. There has been no installment buying.

Senator TOBEY. Is that contemplated? There is a tremendous field for investment. I am speaking primarily of the bonds themselves.

Mr. ECCLES. I would personally not favor the means used in the last war. I think it was inflationary, and I think it was a mistake to sell bonds to individuals and have them go to the banks and borrow the money with which to buy the bonds.

In numerous instances they just let the banks take over the bonds; that is all there was to that. And, in other cases, where bonds went down after the war, as they did do, a lot of people who still held on to their bonds had their bonds sold out to pay the debt. That made for a lot of ill feeling.

I would think a much better way to sell on an installment basis would be to use the system that Canada uses, and that is to sell on a deferred payment plan; in other words, during the period of the drive, you might sell any of these securities that were offered for sale, with a down payment of some kind.

Senator TOBEY. Enough to create a substantial equity.

Mr. ECCLES. With 20 percent, say, and with so much per month over the next few months, not to exceed 6 months.

I think it was a great mistake to sell securities that did not have to be paid for monthly, and that the period of payment should not exceed 6 months. Then instead of borrowing the money to buy the bond, and pay the cash to the Treasury, they would pay the Treasury periodically through their banks.

Now, that might be a very sound thing to do, because it might induce people to commit themselves, so that when they got their money in, they would be under pressure to pay this obligation to protect their equity, whereas if they did not have the obligation they would be tempted to try to spend it for something else rather than save it, and have it on hand for the next drive.

Senator TOBEY. You will excuse me, for I had not known that you spoke to the American people. But, in this grave hour, when we are all speaking of inflation, mounting taxes, exorbitant prices, skyrocketing prices, and failures, it would seem that some advice like this having gone out over the air, in a Nation-wide campaign, do bring people up to realize the enormity of the danger, would be a very nice thing to do right now, and that is why I spoke as I did, sir.

Senator BARKLEY. Are you through, Senator?

Senator TOBEY. Yes, sir.

Senator BARKLEY. Since the $660,000,000 item has been brought up here, I would like to ask you the history and the reason and effect of it.

Mr. ECCLES. I don't know whether this should be put in the record or not, but we have had numerous inquiries from Senators——

Senator BARKLEY. You must have anticipated the question.

Mr. ECCLES. As well as Congressmen on this question, so I have prepared myself.

Senator TOBEY. You are all primed.

Mr. ECCLES. So I have supplied myself with information, and it might be well to place it in the record. It is a lengthy discussion, and quite technical. I do not think you would want me to take the time to read it, but I would like to put it into the record.

Senator BARKLEY. Yes.

Mr. ECCLES. And I would like to make this observation.

The CHAIRMAN. Can you not distribute it without putting it into the record?

Mr. ECCLES. That is all right with me. I will put you people on the mailing list. Any of you people that want it, we will get it to you as soon as we can.

Senator BARKLEY. Why not put it into the record? It is worth while, I think. There is a good deal of misunderstanding about it, among the Members of Congress and the general public.

The CHAIRMAN. Very well.

(The memorandum referred to is as follows:)

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
January 21, 1943.

Mr. MARRINER ECCLES,
Chairman, Board of Governors,
Federal Reserve System, Washington, D. C.

MY DEAR MR. ECCLES: My attention has been called to the issue of Federal Reserve bank notes in the sum of $660,000,000 and the statement of the Board of Governors of the Federal Reserve System issued on December 13, 1942. The claim is made that they are illegally issued, and that the effect on the reserves of the Federal Reserve banks, and therefore on the inflation of the currency, is very different from the issue of ordinary Federal Reserve notes, and more dangerous.

I have read section 18 of the Federal Reserve Act, as amended, which requires that the Federal Reserve banks, in order to obtain these notes, must deposit with the Treasurer of the United States either direct obligations of the United States or notes, drafts, bills of exchange, or bankers' acceptances.

I should be obliged if you would let me know whether these provisions of section 18 have been complied with, and explain to me the exact procedure followed in the issue of these notes.

Sincerely yours,

ROBERT A. TAFT.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

JANUARY 26, 1943.

Hon. ROBERT A. TAFT,
United States Senate, Washington, D. C.

MY DEAR SENATOR TAFT: This is in reply to your letter of January 21 in which you inquire whether in the issuance of $660,000,000 of Federal Reserve bank notes the provisions of section 18 of the Federal Reserve Act have been complied with and requesting also an explanation of the exact procedure followed in the issuance of these notes.

With regard to the legality of the issue, I enclose a memorandum opinion by the general attorney of the Board which shows conclusively that the notes were issued in strict compliance with the law and the regulations thereunder. With respect to the procedure, I attach a memorandum prepared by the staff which gives the details of the procedure followed. You will note that it is in conformity with procedure followed in the past, both with respect to Federal Reserve bank notes and national bank notes.

In addition, I enclose a memorandum which Dr. Goldenweiser, Director of our Division of Research and Statistics, informally prepared after reading the open letter sent to Congress by the secretary of the Economists' National Committee on Monetary Policy. Dr. Goldenweiser fully explained the matter over the telephone to the writer of this open letter and felt indignant that nevertheless the open letter had been sent in the light of the facts and the disturbance of public confidence which could result from a deliberate distortion of the truth.

I trust that this material will acquaint you fully with the facts, but if you desire more information, please do not hesitate to call upon me.

Sincerely yours,

M. S. ECCLES, *Chairman.*

STATEMENT BY J. P. DREIBELBIS, GENERAL ATTORNEY, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, WITH RESPECT TO ISSUANCE OF FEDERAL RESERVE BANK NOTES

On December 12, 1942, the Board authorized the Federal Reserve banks to utilize the existing stock of currency known as Federal Reserve bank notes amounting to approximately $660,000,000. This currency is the remainder of a supply printed in 1933 and is identical with the Federal Reserve bank notes now in circulation.

I am informed that the procedure followed in issuing, redeeming, and retiring Federal Reserve bank notes has been and is as follows. Government securities are pledged with the Federal Reserve agent as agent for the Comptroller of the Currency and upon their deposit the Federal Reserve agent delivers Federal Reserve bank notes to the Federal Reserve bank. However, it has been the practice of the Federal Reserve banks to reduce or extinguish their liability on such notes by establishing credits in the Treasurer's general account. When the credit has been established the collateral is returned to the banks and subsequent retirement or redemption of the notes is effected by charges to the account.

My opinion has been requested as to the legal authority for this procedure.

The issuance and retirement of such notes are governed by the provisions of paragraph 6 of section 18 of the Federal Reserve Act and regulations of the Secretary of the Treasury issued pursuant thereto.

The pertinent provisions of paragraph 6 of section 18 of the Federal Reserve Act read as follows:

"Upon the deposit with the Treasurer of the United States (a) of any direct obligations of the United States * * * any Federal Reserve bank making such deposit in the manner prescribed by the Secretary of the Treasury shall be entitled to receive from the Comptroller of the Currency circulating notes in blank, duly registered and countersigned. * * * The Secretary of the Treasury is authorized and empowered to prescribe regulations governing the issuance, redemption, replacement, retirement, and destruction of such circulating notes and the release and substitution of security therefor. * * * No such circulating notes shall be issued under this paragraph after the President has declared by proclamation that the emergency recognized by the President by proclamation of March 6, 1933, has terminated, unless such circulating notes are secured by deposits of bonds of the United States bearing the circulation privilege. When required to do so by the Secretary of the Treasury, each Federal Reserve agent shall act as agent of the Treasurer of the United States or of the Comptroller of the Currency, or both, for the performance of any of the functions which the Treasurer or the Comptroller may be called upon to perform in carrying out the provisions of this paragraph."

On March 11, 1933, Secretary of the Treasury Woodin issued a regulation which provides for the issuance of such notes and the deposit and maintenance of collateral as security therefor. The pertinent provisions of this regulation will be found in paragraphs 1 and 4 which read as follows:

"1. The Federal Reserve agent accredited to each Federal Reserve bank is hereby authorized and required to act as the agent of the Treasurer of the United States or of the Comptroller of the Currency, or both, for the performance of any of the functions which the Treasurer or the Comptroller may be called upon to perform in carrying out the provisions of such sixth paragraph of section 18, as amended. The term 'Federal Reserve agent' as used in this regulation shall be construed to mean the Federal Reserve agent as agent of the Treasurer of the United States or of the Comptroller of the Currency, or both, as the case may be.

* * * * * * *

"4. Upon deposit with the Federal Reserve agent of the security required by such sixth paragraph of section 18, as amended, the Federal Reserve agent may deliver Federal Reserve bank notes to the Federal Reserve bank to which he is accredited."

On March 31, 1933, Acting Secretary of the Treasury A. A. Ballantine issued a regulation which provides for the retirement of such notes. The pertinent provisions of this regulation will be found in paragraphs 5 and 7 which read as follows:

"5. Deposits by Federal Reserve banks for credit in the redemption fund provided for under paragraph 10 of the regulations approved March 11, 1933, or deposits to retire Federal Reserve bank notes as hereinafter provided may be made by credits in the Treasurer's general account or by payment through the Gold Settlement Fund.

* * * * * * *

"7. Any Federal Reserve bank may at any time retire its Federal Reserve bank notes by the deposit of such notes with its Federal Reserve agent, or may reduce its liability for outstanding Federal Reserve bank notes by the deposit of lawful money with the Treasurer of the United States, and upon delivery to the agent by the bank of any of its Federal Reserve bank notes, or upon advice from the Treasurer or the Federal Reserve bank that a deposit of lawful money has been made by the bank for retirement of its Federal Reserve bank notes, the agent shall have general authority to surrender an equivalent amount of collateral to the bank. Any Federal Reserve bank notes surrendered to the Federal Reserve agent by the bank may be reissued to the bank only on the basis of an original issue. The Federal Reserve agent shall daily report to the Treasurer of the United States, the Comptroller of the Currency, and the Federal Reserve Board the amount of Federal Reserve bank notes surrendered by the bank."

You are advised that, in my opinion, the procedure outlined above meets the legal requirements of section 18 of the Federal Reserve Act and the applicable regulations issued thereunder.

Dated January 23, 1943.

Statement by E. L. Smead, Chief, Division of Bank Operations, Board of Governors of the Federal Reserve System, with Respect to Issuance of Federal Reserve Bank Notes.

In December 1942 the Board of Governors of the Federal Reserve System, with the approval of the Treasury Department, authorized the Federal Reserve banks to pay out the existing stock, approximately $660,000,000, of Federal Bank notes which were printed in 1933. This was done to help meet the extraordinary demands for currency and at the same time conserve thousands of man hours and valuable materials for other purposes. It was estimated that there would be a saving of 225,000,000 man-hours in printing alone and 45 tons of paper, in addition to substantial quantities of nylon and ink.

The issuance of Federal Reserve bank notes was authorized in the Federal Reserve Act as originally drawn in 1913. Such notes were issued during the period 1916 to 1920 and again in 1933, when a shortage of currency appeared imminent at the time of the bank holiday. About $912,000,000 of Federal Reserve bank notes were printed in 1933 (none have been printed since that date), of which about $265,000,000 were issued to member banks for circulation purposes. Between February 28, 1934, when $194,000,000 of Federal Reserve bank notes were in circulation, and March 1, 1935, the various Federal Reserve banks extinguished their liability for Federal Reserve bank notes then outstanding by depositing an equal amount of lawful money with the Treasurer of the United States for their redemption, as provided in the Treasury Department's regulations of March 31, 1933, covering the issue and redemption of Federal Reserve bank notes. From then on the Federal Reserve banks had no liability for Federal Reserve bank notes in circulation. About $18,000,000 of these Federal Reserve bank notes are still in circulation.

In 1935 a similar procedure was followed in extinguishing the liability of national banks for approximately $654,000,000 of national bank notes which were in circulation at the end of July 1935, when the Secretary of the Treasury called for redemption all United States securities available as collateral for currency issued by national banks. The national banks deposited lawful money with the Treasurer of the United States for the redemption of their bank notes then outstanding, and thereupon the liability of such notes was assumed by the United States. There are still about $135,000,000 of national bank notes in circulation.

The Federal Reserve bank notes now being put into circulation are issued by the Federal Reserve banks in accordance with the provisions of the Federal Reserve Act and regulations issued by the Secretary of the Treasury. For all notes issued to the Federal Reserve banks, Government securities were deposited by the Federal Reserve banks with the Federal Reserve agents, acting as agents of the Comptroller of the Currency, pursuant to Treasury Department regulations. Instead, however, of leaving the bonds pledged with Federal Reserve agents as collateral for Federal Reserve bank notes issued by them to the Federal Reserve banks, and showing such notes as a liability, the Federal Reserve banks secured the release of the bonds by depositing lawful money with the Treasurer of the United States in an amount sufficient to redeem all Federal Reserve bank notes issued to them. The Federal Reserve bank notes will be canceled and retired as they become unfit for circulation.

If the Federal Reserve banks had left Government bonds pledged as security for Federal Reserve bank notes they would under the law have paid a tax of one-fourth of 1 percent semiannually upon the average amount of such notes in circulation. The method followed has the effect of relieving the Federal Reserve banks of the payment of the tax, and member banks reserves will be temporarily increased as the funds deposited in the United States Treasurer's general account are checked out. This effect on member bank reserves will be reversed as the Federal Reserve bank notes are redeemed and retired from circulation.

Authority for Federal Reserve banks to issue Federal Reserve bank notes will expire when the President proclaims that the emergency recognized in his proclamation of May 6, 1933, has terminated.

Dated January 25, 1943.

STATEMENT BY E. A. GOLDENWEISER, DIRECTOR, DIVISION OF RESEARCH AND STATISTICS, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, WITH RESPECT TO ISSUANCE OF FEDERAL RESERVE BANK NOTES

Walter E. Spahr, professor of economics at New York University, and secretary of the Economists' National Committee on Monetary Policy, addressed an open letter to Congress on January 20, 1943. In this letter he says that the issuance of Federal Reserve bank notes by the Treasury up to $660,000,000, or any other amount, is not authorized by law; that these notes must be issued by the Federal Reserve banks; that they are not being issued by these banks and are not liabilities of these banks, and that the statement on the face of these notes, that they are secured by United States Government obligations, is a falsehood.

First, as to the law. The law and regulations thereunder authorize the Federal Reserve banks to issue Federal Reserve bank notes against Government securities pledged for the purpose and to extinguish their liability on these notes by depositing lawful money with the Treasurer of the United States. When the Reserve banks' liability has been extinguished in this manner, they are at liberty to withdraw the Government securities that were pledged against the notes. What was done is precisely that. The notes were issued by the Reserve banks and Government securities were pledged against them. Lawful money was deposited with the Treasurer of the United States by giving the Treasury a deposit account at the Federal Reserve banks, which is withdrawable at any time in gold certificates, silver certificates, or any other lawful money. In this way the liability on the notes was extinguished, and the securities back of the notes were then withdrawn.

The accusation that the words "secured by United States bonds" on the notes is a falsehood is specious. It is true that they are no longer secured by bonds because of the series of transactions which has been described. But they are secured "by like deposit of other securities" to wit, lawful money. The transaction is identical with the course followed in the case of Federal Reserve bank notes in 1941–42 and 1934–35. It is identical with the course pursued at the time that national bank notes were taken over from the national banks and made liabilities of the Treasury. These notes, the same as Federal Reserve bank notes, are no longer secured by United States obligations but by lawful money and require no other collateral.

The particular point that Mr. Spahr makes about the notes being labeled "national currency" would be puzzling if one did not know how it happened, as he should know. The reason the words "national currency" appear on these notes is that at the time of the banking holiday in 1933, when it became necessary to be prepared to meet currency withdrawals in case they should continue after the banks reopened, it was essential to print the notes in a hurry. For this purpose existing plates of national-bank notes were used, with some overprinting. This was in accordance with law which provides that the Secretary of the Treasury has authority to determine the form of any United States currency that is issued.

The next question is as to the good faith of the Board when it stated that the purpose of issuing these notes was to save the paper and manpower necessary for printing other notes. The fact is that that was the sole purpose of the issue. These notes were in existence; they were lying idle, and it would have taken 225,000 man-hours, 45 tons of paper, and some other scarce materials to produce a supply of other notes.

It is true that the Treasury as a result of this transaction got the use of $660,000,000 without interest for the period until these notes will have been retired. That this was not one of the objects of the issue is apparent, however, from the circumstances surrounding the issue. It costs the Treasury about three-eighths of 1 percent a year to borrow the money which it would have had to have if the notes had not been issued in the manner indicated. But in that case the Federal Reserve banks would have had to pay the Treasury one-half of 1 percent tax on the notes, so that as a matter of fact the Treasury sustained a nominal loss as a result of using the method of issuing the notes that was adopted.

All this, however, is within the realm of reasonable discussion and debate. But, beyond this point, Professor Spahr proceeds into a long discussion based on the supposition that the Federal Reserve bank notes will add 660 millions to the reserves of the Federal Reserve banks; that this amount will support in round numbers 1.9 billion dollars of Federal Reserve bank deposits, and that this in turn will support about 9.5 billions of member bank deposits, or if reserve requirements are reduced to 10 percent as the law permits, it will support 19 billions of member bank deposits.

It is in the future of 19 billions of deposits added to the paying medium of the country that Professor Spahr sees danger to the economy and inconsistency with the policy of the Government in trying to prevent inflation. The facts of the matter are that the 660 million dollars are not being added to the Federal Reserve banks' reserves, since they are being paid out into circulation as fast as there is a demand for them. A delay of some weeks in some instances may occur where the notes are in denominations of $50 and $100, which do not circulate rapidly. All of the notes, however, will be paid out in a relatively short time.

The other and much more important fact is that, even if those notes were added to the reserves of the Federal Reserve banks, this would be an act of supererogation. The Reserve banks now have 11 billions of excess reserves. On the basis of these reserves, following Mr. Spahr's calculations, they could build up a member bank deposit structure of 300 billions of dollars, in comparison with which the Professor's 19 billions would fade into insignificance. To build up a vast monster of inflationary danger by assuming such an addition to the reserves of the Reserve banks (even if it should occur, as it will not) and then to accuse the Government of an improper act on that score—is to exceed the boundaries of responsible discussion.

Dated January 25, 1943.

[From the New York Herald Tribune February 1, 1943]

MUCH ADO ABOUT VERY LITTLE

Walter E. Spahr, secretary of the National Economists' Committee on Monetary Policy, charged in an "open letter to Congress" not long ago that the recent issuance of $660,000,000 in Federal Reserve bank notes (not to be confused with Federal Reserve notes) by the Treasury constituted "greenbackism."

This newspaper yields to no one in its devotion to the belief that a government cannot be too punctilious in discharging its responsibilities with respect to the soundness of the nation's currency. But it seems to us that with all due respect to Mr. Spahr's good intentions he is, in this instance, trying to create a tempest in a teapot.

The Bureau of Engraving and Printing at Washington has been under tremendous pressure now for months. Because of the expansion in the volume of currency, on the one hand, and the necessity of printing War Savings bonds and ration books, on the other hand, it faces, like so many other establishments at this time, shortages of materials and labor. No Federal Reserve bank notes have been put into circulation now in many years, but back in the days of the banking crisis of the 'thirties some $700,000,000 were printed for emergency purposes. Only a few of these were ever used, and the rest have been lying idle since then in the banks' vaults. The Federal Reserve Board's experts got out paper and pencil and figured that if these notes could be put into circulation it would dispense with the need for printing new currency in that amount, with a saving to the Government of $300,000, some 225,000 man-hours and 45 tons of paper.

The board decided, with great common sense, it seems to us, that these notes should be put into circulation on the understanding that they should be retired when worn out, which means within a period of perhaps 6 months. The Treasury has assumed the obligation so to retire them and has made it unequivocally clear that there is no intention whatsoever to replace them with new notes. That, in simple terms, is all there is to the episode. To speak of this operation as constituting "greenbackism" or "currency inflation" at a time when the Nation is expanding its currency at the rate of upward of more than $4,000,000,000 a year and its bank deposits (the real money of the country) by several times that amount, not only suggests an undue preoccupation with the minutiae of monetary policy; it comes close to suggesting a lack of a sense of humor.

Mr. Eccles. Let me say this: In the first place this was done after a great deal of consideration. The attorneys for the Board rendered us a legal opinion before it was done, and I have included in this memorandum an opinion of our General Attorney.

The Chief of the Division of Bank Operations prepared a statement as to the procedure and the mechanism before it was done.

The Chief of the Division of Research and Statistics prepared a statement covering the economics of the thing. We did not do this without full and complete consideration from the legal, from the operating, and from the economic point of view.

Now, you can say that this is inflationary, but as I say it is academic. As I said before, borrowing from the banks is inflationary. Even issues of silver certificates is inflationary, in the same way that you are arguing here, that here are notes put out, and there is nothing back of them.

There is this back of them; the promise of the United States Government to pay. If we had deposited back of them, and left back of them the bonds, Government bonds, that is nothing more than a promise of the United States Government to pay, so that you would have had no more back of the notes if the bonds were deposited.

Senator Tobey. Then you are lending a little color to the Patman theory, now, aren't you?

Mr. Eccles. I am not lending color to the Patman theory, because under the Patman theory he only takes one side of the issue. But, what I am trying to point out here is that this is not inflationary, except as an academic matter, when we are having to put reserves into the banking system today at the rate of more than $5,000,000,000 a year.

All this amounts to is about what would be 1 month's requirements in the providing of reserves.

Senator Butler. How does the amount happen to be $660,000,000?

Mr. Eccles. Well, I am glad you mentioned that, because I do not want to overlook the reason for the issue.

The reason for doing this was not to provide reserves, was not to provide credit at all, because the Treasury has got to pay these notes off as they come due.

The average life of currency is less than a year. While the putting out of these notes increased the deposits in the banking system and increased the reserves in the banking system, they will decrease the deposits and decrease the reserves when they are paid off.

The only reason and the sole reason for putting out these notes was a matter of saving paper and manpower, when it was so vitally needed. We had this situation. I want to get the figures on this; just a second.

I might read an excerpt from the New York Herald Tribune which meets this issue about as effectively as anything I know. This is a quotation from their editorial.

The Bureau of Engraving and Printing at Washington has been under tremendous pressure now for many months. Because of the expansion in the volume of currency, on the one hand, and the necessity of printing War Savings bonds and ration books, on the other hand, it faces, like so many other establishments at this time, shortages of materials and labor. No Federal Reserve bank notes have been put into circulation now in many years, but back in the days of the banking crisis of the thirties some $700,000,000 were printed for emergency purposes.

It was more than that. There was a total of $912,000,000 at the time of the bank holiday. There was put into use $265,000,000. Of that $265,000,000, I think all but $18,000,000 has disappeared; been retired. They possibly are lost or in hoarding.

That leaves, of the amount printed, $660,000,000, which has laid in the vaults of the 12 Federal Reserve banks since 1933.

Now, they were there, already shipped out, express paid, printed, and so forth. Now, only a few of these were used, and that was the two-hundred-and-some-odd million dollars I mentioned.

The Federal Reserve Board's experts got out paper and pencil and figured that if these notes could be put into circulation it would dispense with the need for printing new currency in that amount, with a saving to the Government of $300,000, some 225,000 man-hours and 45 tons of paper.

To say nothing of ink, and rayon, and other things, nylon, and other materials used in printing.

Senator TOBEY. How many tons was that?

Mr. ECCLES. Forty-five tons.

Senator TOBEY. So that the issue of $660,000,000 of notes took 45 tons of paper?

Mr. ECCLES. That is right.

Senator TOBEY. Is it possible?

Mr. ECCLES. Yes, sir.

Senator TOBEY. That seems enormous.

Mr. ECCLES. That is the paper used in the manufacture. They were already printed. We would never have thought of doing this, if they had not already been in existence and were in the vaults of the Federal Reserve banks, and the supply of notes was running down to almost the zero point, due to the tremendous increase in currency in circulation and because the Bureau of Printing and Engraving was so far behind as a result of the terrific load that they had put on them in the printing of Government securities and all of the other work they had to do.

This, of course, was put out at the time just before the holiday period, when the volume of currency was enormous. The volume of currency just went up like a balloon, at that time, and we decided that the sensible and the practical thing to do was to take these notes and put them out and they would be back within a reasonable time.

Just let me finish one more paragraph, because this seems to me to be very pertinent on this subject.

The Board decided, with great common sense—

Now, that is from the New York Herald Tribune.

Senator TOBEY. You are not saying that yourself?

Mr. ECCLES. No.

it seems to us that these notes should be put into circulation on the understanding that they should be retired when worn out, which means within a period of perhaps 6 months. The Treasury has assumed the obligation so to retire them and has made it unequivocally clear that there is no intention whatsoever to replace them with new notes. That, in simple terms, is all there is to the episode. To speak of this operation as constituting "greenbackism" or "currency inflation" at a time when the Nation is expanding its currency at the rate of upward of more than $4,000,000,000 a year and its bank deposits (the real money of the country) by several times that amount, not only suggests an undue preoccupation with the minutiae of monetary policy; it comes close to suggesting a lack of a sense of humor.

Senator DANAHER. When you put out these $265 million Federal Reserve bank notes under the 1933 Banking Act, Mr. Eccles, only Federal Reserve banks could put them out, and they could put them out only if they made a deposit of Government bonds, and, as I recall it, 5 percent of the lawful money of the United States to secure the issue; isn't that so?

Mr. ECCLES. That is right.

Senator DANAHER. Now, what did they put up this time, then, as collateral?

Mr. ECCLES. We did exactly the same thing this time as last time. The regulation that the Federal Reserve followed at this period, in putting out these notes, was a regulation issued by the Treasury on March 31, 1933. Acting Secretary of the Treasury A. A. Ballantine, issued a regulation which provides for the retirement of such notes, and the pertinent provision in this regulation will be found in paragraphs 5 and 7, and so forth. It is a legal document, and you as a lawyer will be interested in reading it.

What I want to make clear is this——

Senator DANAHER. Before you make your point, did you, when they were first put out in 1933, require that the Federal Reserve bank assume the liability with reference to them?

Mr. ECCLES. The Federal Reserve bank did not at this time——

Senator DANAHER. Not this time; in 1933.

Mr. ECCLES. No.

Senator DANAHER. Did they put up Government bonds and 5-percent reserves against it?

Mr. ECCLES. They put up Government bonds just as we did at this time. We put up the Government bonds with the Federal Reserve agency.

I will see if I can explain the mechanism that we went through this time and the last time. These notes were released from the Federal Reserve agent in each bank by the authority of the Comptroller of the Currency. United States Government bonds were deposited with the Federal Reserve agent to cover the release.

These notes, of course, could only go out as the public wanted currency. We then would put out the notes we had, either Federal Reserve bank notes, or Federal Reserve notes, or silver certificates; I mean, the form of currency that was available we would put out.

Now, the regulation referred to permits these bonds to be replaced by cash, or credit which was done in 1933, and was done again in the present instance by depositing with the Treasury $660,000,000.

So, the Federal Reserve banks, after complying with the requirements of depositing bonds against the notes with the Federal Reserve agent, then retired the bonds by establishing a credit to the Treasury, and the Treasury assumed the obligation of retiring this currency.

Now, that is exactly what was done in 1933, as I say, under this act, and under the regulation issued by Mr. Ballantine at that time.

Senator DANAHER. When the Federal Reserve banks, in 1933, put them out, the Federal Reserve bank notes became liabilities of the Federal Reserve banks, did they not? Well, in this case, it is not a Federal Reserve bank liability but a liability of the Treasury.

Mr. ECCLES. It was just as much a liability of the Treasury at that time. The Treasury assumed the liability at that time, because the regulations provide that you may deposit to the credit of the Treasury the amount of the notes, and in doing that the Treasury would have to assume the liability, and that is what was done. The Treasury did assume the liability.

So far as Federal Reserve notes are concerned, they are today the liability of the Federal Government as well as the liability of the Federal Reserve banks.

Now, these notes are liabilities of the Federal Reserve banks, but the Treasury assumes the liability, and if the Treasury failed to take them up, I suppose the Federal Reserve banks would have to. But, the point is that Federal Reserve notes and Federal Reserve bank notes, as I understand it, are the liability of the Federal Reserve banks. They are likewise guaranteed by the United States Government.

In the case of these Federal Reserve bank notes, the Treasury has assumed the liability for the redemption as fast as they come in, and the Government will have to redeem these notes and the Government's account at the Federal Reserve bank will be debited as fast as those notes come in, and are canceled.

Now, that is what will happen. It will actually automatically cancel the $660,000,000 as they come in.

Now, if there had been any desire to create an inflationary process on the part of the Government, or the Federal Reserve, we did not have to use this particular mechanism. The Thomas amendment has been on the books since 1933, and has never been used. We never had any thought or intention of using it.

Senator TOBEY. At the same time when you try to repeal it, they protest very bitterly. They say they will not use it, but do not repeal it.

Mr. ECCLES. So far as I am concerned, I have no objection to repealing it.

Senator TOBEY. It is still a sword of Damocles hanging up there.

Mr. ECCLES. Yes. But inflation will never come from the issuance of currency.

Senator TOBEY. I think you are right.

Mr. ECCLES. The only way inflation can come is through the Congress of the United States appropriating money. Now, there is no other way you can get inflation, except the way that Congress appropriates money and fails to provide means of collecting it.

Senator TOBEY. It seems to me, Mr. Eccles—and I make this prediction, that some of our printing-press-money friends, fiat-money friends, will use your words this morning to plague you, wherein you speak of these notes and the Government's promise to pay. If we put behind them Government bonds, that would have been a promise to pay. Taking that away from the context entirely, they will quote Marriner S. Eccles and say that is the law.

Mr. ECCLES. I have a statement, if you would like to have it. I wrote Mr. Patman and I have debated this issue with him time and time again——

Senator TOBEY. I know you have.

Mr. ECCLES. On the subject of orthodox means of financing, and you can see just what Mr. Patman proposes and then what is the effect of it. That in itself would not create inflation if you did just what Mr. Patman proposes. That is not the inflationary route.

The objection to what the Patmanites propose is that you would create a huge volume of deposits; you would create a like amount of excess funds on the part of the banks; but you would have the banks without any earnings assets. With all of the present work and time and expense involved, you would either have to provide the banks with an income to replace the bond interest, or you would not have any banks. So the point is whether you provide them with the income through orthodox means, which is the cheapest and the easiest and the best way to do it. Mr. Patman cannot save the Government anything by his proposal.

Senator TOBEY. Are you thinking of suggesting to the bond selling agents in the country that deferred method of selling Government bonds in this war now?

Mr. ECCLES. How was that?

Senator TOBEY. The method of deferred payment, do you think that should be suggested?

Mr. ECCLES. That matter has been suggested to the Treasury by the Federal Reserve System.

Senator DANAHER. Mr. Eccles, aren't the Federal Reserve banks now bound to maintain a 35 percent reserve in lawful money against their deposits?

Mr. ECCLES. That is right.

Senator DANAHER. Then, if we do turn over to them Federal Reserve bank notes in the amount of $660,000,000, aren't they in a position to inflate their credit immediately by 65 percent additional?

Mr. ECCLES. Not the Federal Reserve banks, because when you turn that currency over to the Federal Reserve banks, immediately on the one side you have the currency, and on the other side you have credit to the Treasury.

Now, when the Treasury spends that $660,000,000, it is gone, but as long as that $660,000,000 is there, you have to carry against that deposit 35 percent reserve.

Senator DANAHER. Yes.

Mr. ECCLES. All right. Now, if you put up a bond, there is no deposit at all, so there is no reserve required. The point is, if you put up the bonds, you put up the bonds and issue currency. You create no deposit then, and therefore there is no reserve involved.

The mere issuance of this currency does not create any deposit. It merely takes the place of Federal Reserve notes or other forms of currency. It does not increase the total volume of currency at all.

Senator DANAHER. Why couldn't you just take the $660,000,000. then, without going through the transaction of posting the bonds; post the credit and then take the bonds back?

Mr. ECCLES. Well, I suppose theoretically you could do that.

Senator DANAHER. In any case, the limit of possible expansion would be the $660,000,000.

Mr. ECCLES. That is correct; that is right.

Senator DANAHER. Either in currency or in credit expansion.

Mr. ECCLES. If you did what?

Senator DANAHER. Well, by this transaction that you have described, the very limit is $660,000,000.

Mr. ECCLES. That is right. The only way we get any more than that is to print more notes, but simply repeat the process.

Senator DANAHER. Yes, that is right.

Mr. ECCLES. Now, it has been proposed—I think it was Senator Taft who introduced the bill, proposing to repeal the power that was given. Now, as far as I am concerned, I would not have the remotest objection to the repealing of the power to issue Federal Reserve bank notes.

I think it has fully served its purpose, and there is no need of having that power on the statute books, so I can say, so far as I am concerned, and I take it the Board feels the same way, they would have no objection to repealing it.

Senator DANAHER. To limit it to $912,000,000 in the first place? That is all it is now.

Mr. ECCLES. It was at that time.

Senator DANAHER. Yes.

Mr. ECCLES. We paid for those notes, shipped them to the banks, and we will have used them when they come back. We have no thought and never had of printing any more notes, and so far as the power is concerned, I see no reason why it cannot be repealed.

Now, another thing that Mr. Taft proposes is the recalling of these notes before they are used up. That would be perfectly ridiculous, and I would be very much opposed, having put them out now, to calling them in. Let them come in normally. But, the other part of the bill I have no objection to.

Senator BARKLEY. Mr. Eccles, is it correct to assume if you had not put out the $660,000,000 of these notes that have already been printed and available all these years, that you would have had to have found some way to put approximately that much money in circulation?

Mr. ECCLES. What we would have put out would have been Federal Reserve notes. But, the stopper is we were running short of printed currency.

Senator BARKLEY. But if you could have gotten them printed without a great deal of cost, and without consuming paper and manpower, it would have been advisable in some form to put out that much money.

Mr. ECCLES. That is right.

Senator BARKLEY. For the time being.

Mr. ECCLES. That is right.

Senator BARKLEY. So that what you did, you just were fortunate in having these notes already printed, and you did not have to go through the trouble of printing some more.

Mr. ECCLES. That is right. But, we do not determine the amount of notes to be put out.

Senator BARKLEY. I understand that.

Mr. ECCLES. We have no power to determine that.

Senator BARKLEY. I understand.

Mr. ECCLES. It is the individual person that determines that.

Senator BARKLEY. I realize that. But, you did put these out and they were put out for a definite purpose.

Mr. ECCLES. What we did was this——

Senator BARKLEY. You allowed them to get busy. They were already out.

Mr. ECCLES. No, we had them in storage in the vaults, in print and unauthorized; I mean unauthorized to be used. In order to be able to put them into circulation, we had to deposit with the Federal Reserve agents, bonds of a like amount. We later took up these bonds, and replaced them with a credit to the Treasury for $660,000,000 to redeem the notes as they come back from circulation.

Now, the Treasury could spend that $660,000,000 out of their general account, just as they can spend any other money, tax money or any other money.

So, here was $660,000,000 that the Federal Reserve had given to the Treasury without interest. That is what it amounts to. But, the Treasury has to stand ready with that $660,000,000 to redeem these notes as they come in. That is the fund that redeems them.

So, if the Treasury uses that $660,000,000 credit, then they have to use other money to redeem these notes just as fast as they come in, and the Federal Reserve banks charge their account with the notes.

So, you see, it extinguishes itself.

In putting notes out, when the member banks ask to have currency shipped to them to meet the requirements of their customers, we can ship whatever currency we have. It may be silver certificates; it may be Federal Reserve notes, or in this case, Federal Reserve bank notes.

Now, because of the shortage of Federal Reserve notes, because of the printing, you can keep putting them out just as soon as the public has money deposited to have a call on them. A bank can keep demanding you issue it currency just as soon as the bank has funds with you, so it is the customer first that determines the amount of currency. It is the banks that furnish it to the customer. The banks, in turn, come to the Federal Reserve. So, we have no option except to furnish whatever currency these people have a call on.

Now, they make their call on this currency, by and large as a result of what the Government is spending. That is where the call comes in, by the amount of purchasing power created in hands of the public. That gives you the volume of currency. So, we are merely the machine that has to furnish and provide this currency, and by providing currency we do not provide inflation

Inflation is provided at the other end, by giving them the purchasing power.

Senator TOBEY. That is the dynamite.

Mr. ECCLES. The dynamite is the purchasing power you are creating by Government spending.

Senator BARKLEY. Earlier in your statement you said you were increasing currency, or the equivalent, at the rate of about $3,000,000,000 a month.

Mr. ECCLES. No; I said deposits.

Senator BARKLEY. Well, you said that was really currency.

Mr. ECCLES. Well, the actual currency in circulation last year increased $4,000,000,000.

Senator BARKLEY. In the year?

Mr. ECCLES. That is correct.

Senator BARKLEY. So, your $3,000,000,000 a month increase did not have any relationship to that item at all?

Mr. ECCLES. That is in addition.

Senator BARKLEY. Yes. Now, this 40-billion gap that you spoke of awhile ago that you said might be absorbed by Congress if it provided a tax——

Mr. ECCLES. Of course, they cannot provide it all.

Senator BARKLEY. Of course not.

Mr. ECCLES. That was theoretical; academic.

Senator BARKLEY. As I say, there is no way to absorb all of the surplus income that every individual in this country gets, either by taxes or by any other method.

Mr. ECCLES. No; that is right.

Senator BARKLEY. There will be a slack in there.

Mr. ECCLES. No Government, in a war period, has ever been able to avoid some inflation, and no Government has ever been able to absorb its expenditures. It is politically impossible through tax or by borrowing it all from the people. There has always been some expansion and inflation.

However, our expansion is much worse than that of our allies in the war. We are financing a much larger percentage of our deficit through borrowing than they are. Our percentage of tax in relation to our spending is no more than about half of what the Canadian and the British taxes are in proportion to their spending. Our borrowing from the public is very much less than theirs. Our borrowing from the banks is very much greater than either of them, so that by comparison with other countries, the job we are doing is very bad.

Senator RADCLIFFE. I would like to ask you a question, following what you said. Of course, we are all naturally interested in anything which will stimulate the purchase of bonds by individuals.

I think you said a few moments ago that among the things which would tend to discourage inflation was an increase in tax and also an increase in purchases of bonds by individuals.

I think you also said that the plan which was used during the last war, by which the banks would finance these purchases, was not desirable, but that on the contrary there should be some method by which the bonds could be purchased on the deferred payment basis.

Mr. ECCLES. From the Treasury direct.

Senator RADCLIFFE. From the Treasury. Now, let me ask you a question: Who would hold those bonds until they were paid out?

Mr. ECCLES. The bank.

Senator RADCLIFFE. The bank?

Mr. ECCLES. The bank, because the bank would be the collecting agency for the Treasury.

Senator RADCLIFFE. You said a moment ago that one of the objections to the whole plan was the fact that there was too much of a tendency on the part of the purchasers of these bonds under the old plan by which the bank financed them to just give up the transaction and let the banks keep the bonds.

Mr. ECCLES. A lot of people thought it was a gift that they were making.

Senator RADCLIFFE. I realize that. If, on the plan you suggest, these are bought on the deferred basis, but the bonds are held by the banks, which is more or less a collecting agency, wouldn't there still be the same degree of temptation to the individual?

Mr. ECCLES. Not if you required a down payment.

Senator TOBEY. Or a substantial equity created in the first place.

Mr. ECCLES. Before the Treasury would accept a subscription, it would have to be accompanied by, say, 25 or 20 percent.

Senator RADCLIFFE. That is correct.

Mr. ECCLES. Now, today the banks loan 100 percent on a Government bond.

Senator RADCLIFFE. In other words, the only difference would be that the down payment would be larger.

Mr. ECCLES. No. There is a very substantial difference from a monetary point of view. If a purchaser of a bond borrows all the money from the bank to purchase that bond, you create new money right there, and the Treasury then has a lot of money created that it has not had before.

Now, on the other end, the individual, instead of paying for the bond by the creation of new money, which would be inflationary, would pay for the bond out of his current income. He gives it to the Treasury today, and the Treasury spends it tomorrow. What this does is to put into circulation through the Government some of his current income, whereas if he goes to the bank, borrows the money and pays for the bond to the Treasury in full, you have created that much new money, and it is just exactly the same as if the bank bought the bond itself.

Senator RADCLIFFE. Mr. Eccles, when the bank does the financing, and a down payment, we will say, of 20 percent was required, or just whatever amount you have in mind, or if the bonds are purchased from the Government; in other words, if the down payment is the same, irrespective of whether the bank financed it, or whether it is all through the Government, through a deferred payment, then you don't think there would be any objection?

Mr. ECCLES. Yes. There is a difference that I have just indicated. If it is a deferred payment plan, the individual is turning to the Government his current income. He is not creating any new money.

If he goes to the bank and he borrows the cost of the bond, or 80 percent of the cost of the bond, then you have inflated the total supply of money by that amount.

Now, true the purchaser would start paying the bank off out of his current income, and reduce that credit that had been created instead of paying the Government out of his current income. Now, it is far better to avoid the creation of that credit than merely to extinguish it through its payment. Why not pay into the Government out of his current income and avoid the creation of the credit which he has to create if he goes to the bank? That is the difference.

And, it is much better not to finance through the bank. It would be much better to finance the other way. There is no prohibition, however. He can go to the bank today and make his own arrangements, and the bank can make a loan to people on Government bonds. Certainly, we cannot prohibit banks making loans, so that is certainly permitted.

However, to give that a Nation-wide sponsorship, as a part of a campaign to sell Government bonds would be much less desirable as I have indicated, than the partial payment plan.

Senator RADCLIFFE. Would there be any more difficulty in the way of a man buying from the Government under the plan which you suggest than if he bought from the bank?

Mr. ECCLES. No. As far as the individual is concerned, he would have much more hesitancy about signing a note for $1,000 than he would about subscribing for a $1,000 bond and agreeing to pay for it periodically.

In the one case he puts his name on a $1,000 note, and he puts up his $1,000 bond as security, with some margin. The bank might require margins. And, I think that an individual would be much more willing to sign a note agreeing to make partial payment.

We know when a person buys an automobile, or many of the comparable items that were bought on installment, that you never would have sold those goods if he had to go to the bank to borrow the money and then pay cash for it. They would not go to the bank and borrow money to pay cash, but they would be perfectly willing to sign title-retaining notes for those goods and pay over a period of time.

Now, this is the same sort of thing. The Government retains title to the bond and you pay for it over a period of time.

Senator RADCLIFFE. How would the transaction initiate in either instance? He would go to the bank, I take it, and make arrangements there. He would not deal with the Government in the beginning at all, or any of its agencies, would he? He would go to the bank just as though he were intending to finance his transaction through the bank.

Mr. ECCLES. What he would do would be this: These committees of thousands of people, voluntary workers for this drive, would have the form of subscription, and they would go around and get subscriptions for Government bonds. In many cases the purchaser will give him a check and pay for the bond in full, and sign the subscription.

In this particular case, he signs a subscription which calls for partial payment, and he may not even go to the bank at all. These subscriptions might be taken to the bank by the committees who are handling the financing. I suppose he would have to be given notice that his payment was due, or he would indicate to this bank that he did business with where he wanted to make his payment. He would have to designate on that where he wanted to make payment. He may make it through the mail and never go to the bank.

Now, of course the bank would have to agree to act as agent. They would, no doubt, have to be paid some actual pocket outlays.

Senator RADCLIFFE. If he did not go to the bank, how would he know what bank had the obligation? He is buying through some agent.

MR. ECCLES. That would be designated on his application.

Senator RADCLIFFE. It would be designated on the application, you say?

Mr. ECCLES. Yes; and he would get a copy of it.

Now, there is no such plan in effect. I am merely telling you what is in effect in Canada, and what has been discussed here. It has not been decided, and it may not be put into effect, but if we are going to sell on a partial payment plan, I say it would be better on that sort of a basis than to borrow from the bank the cost of that bond and pay the bank, which was done in the last war.

Senator RADCLIFFE. I was not raising any objection to the plan. I was just trying to analyze the technique in each case from the standpoint of the purchaser.

Mr. ECCLES. Yes; does that meet your inquiry?

Senator RADCLIFFE. Yes.

The CHAIRMAN. Just one sort of general question I would like to ask finally: You talked about a $40,000,000,000 excess that we now have. I suppose that is above taxes and normal expenditures, and so forth.

Mr. ECCLES. What that is, Senator, is the difference between what we consider the spendable income would be for this calendar year of 1943, and the estimated supply of civilian goods and services that will be available at the present level of costs.

The CHAIRMAN. All right. You said there was about $40,000,000,000 of that excess now.

Mr. ECCLES. At least $40,000,000,000 for the year.

The CHAIRMAN. Yes.

Mr. ECCLES. The total amount for the year.

The CHAIRMAN. Yes. Of course, you include in that taxes that are now imposed.

Mr. ECCLES. No. That is after the taxes are out. You would have more.

Let me give you the figure. There is about, I think, roughly, $125,000,000,000 of spendable income that would go to individuals. That is spendable income of all kinds, individual necessities, rents, wages, salaries, services; total spendable income.

The present tax picture will give you about 15 or 16 billion, that is, on individuals. Now, corporations are out of this.

The CHAIRMAN. Yes.

Mr. ECCLES. That gives you $110,000,000,000 of spendable income after taxes.

The O. P. A. and all of the people who are studying this question of consumer goods available figure that at the outset they estimtae about $70,000,000,000 at this price level of civilian goods and services would be available, at the maximum.

At the rate we are diverting people into the Army, the Navy, and into the war production fields, the shrinkage in our civilian supply might not even leave that available, at this price level. If it should leave $70,000,000,000 available, consumer goods and services, and you subtract that from $110,000,000,000, after individual taxes, you have $40,000,000,000.

Now, that is the picture. The people will have $40,000,000,000 more to spend than there will be goods and services available at this price level.

The CHAIRMAN. I think we all recognize the danger of that. You said that Congress is the only one that can take care of that situation.

Mr. ECCLES. That is right.

The CHAIRMAN. All right. Now, why?

Mr. ECCLES. Well, after all, it is the appropriation of the funds and not providing means of meeting those funds that creates the gap. If you appropriate more funds than you provide for in taxes and enforced savings, then the difference becomes your gap.

Now, as to this gap of $40,000,000,000, to the extent that we are able to sell to the public Government securities, to the extent that the public will use their money to pay off debts, more or less——

Senator TOBEY. And to the extent rationing is effective.

Mr. ECCLES. I am just going to effect the saving. To the extent that this $40,000,000,000 is saved now, we estimate if the people will save the same proportion of their national income in 1943 that they saved in 1942, through the purchase of insurance, through putting money in savings banks, institutional savings, through the direct purchase of Government bonds of all kinds,through the payment of debt, through increases in their holdings of deposits, all of which is a savings, and is not being spent; to the extent they save as much in 1943 as they did in 1942, the same percentage, they should save $24,000,000,000. That leaves $16,000,000,000 of a gap. That is where you get that $16,000,000,000 of needed taxes, or enforced savings.

The CHAIRMAN. Now, how are you going to save that?

Mr. ECCLES. You either have to raise all the taxes, or enforce savings, or both. If you do not, you just do not meet it.

Senator BALL. Actually you have a higher figure, because as your tax and enforced savings program goes up, the volume of voluntary saving goes down.

Mr. ECCLES. That is absolutely correct, and the conversion of capital, and so forth.

Of course, the real way to have met it would be to stop inflation at the source before your whole structure profits and wages and farm prices went up.

Senator TOBEY. Right in this room, sitting where you are, was Leon Henderson, with the men around this table, at the time that problem was discussed, and the question was asked the very first day of the hearing: Can we control inflation without freezing the price on labor, or ceilings on commodities and farm products, and all; in other words, a general freeze? And, they were opposed to it.

And, I ask you now the same thing in retrospection—this is not a post mortem—would it not have been wise if we had done that, to have held this thing down to the greatest minimum we could, by such a procedure.

Mr. ECCLES. Well, I feel strongly on the subject, and I say that when you freeze prices, the freezing of prices in itself does not get at the problem. When you freeze prices, you should also freeze the elements that are responsible for the creation of prices, and for the pressures that are making prices go up.

Why do you want to freeze prices? You want to freeze prices because they are going up. Now, you better begin to deal with the causes when you deal with the effect. Don't just deal with the effect of the thing and let the causes go. So, when you fail to freeze the elements that make up the price, it makes no sense to freeze the price.

The CHAIRMAN. What are those elements?

Senator TOBEY. Go to the next step. What about the elements?

Mr. Eccles. I felt very strongly that this is what should have been done. If you freeze your price structure along with that, you should have frozen your whole wage and salary structure as a part of it. You should have frozen your agricultural picture at that point. You should have put in a heavy withholding tax, and a post-defense credit; I mean, enforced savings.

Now, that thing all went together as a part of that picture, and the reason you are having trouble is that you froze prices and you didn't do the other things, and you are now——

The Chairman. Labor is very much frozen now, isn't it?

Mr. Eccles. Yes; but that was 6 or 8 months ago, and so were farm prices. The whole thing was late. You have done nothing on the withholding tax and other things. They are very late.

The Chairman. How about limiting the $25,000 a year salary?

Mr Eccles. How about what?

The Chairman. Limiting salaries to $25,000 a year?

Mr. Eccles. Well, I would prefer not to get into a discussion of that.

The Chairman. Well, I mean you were talking about wages, and you were very definite about that.

Mr. Eccles. I was in favor of freezing all salaries and wages where they were. Of course, when you say $25,000, they did not freeze them necessarily where they were. They reduced a lot of them.

Senator Tobey. Is it a fair statement to quote Marriner Eccles as favoring the repealing of the Thomas amendment?

Mr. Eccles. Well, the Federal Reserve Board, the whole Federal Reserve System, gave you a memorandum on inflation 2 years ago last January. We sent a special communication to the United States Senate and to the House of Representatives, with reference to this question of inflation, and it called for certain repeals, and it called for other things.

Senator Tobey. Did Mr. Morgenthau concur in it?

Mr. Eccles. No. There was a statement made by Mr. Morgenthau, and I think by Mr. Jones, at the time, and after that, at a press conference, they indicated that at that time there was no evidence of inflation.

Well, I will admit there was no evidence of inflation, but I will also admit that the repeal of those things was purely academic, and for that reason I felt we should not take the onus of having it on the books, when it was academic. Why not get rid of a thing if you don't expect to use it?

Senator Tobey. Now it takes form and substance, and almost becomes a reality, doesn't it?

Mr. Eccles. In the Thomas amendment?

Senator Tobey. No; I am speaking of the danger of inflation.

Mr. Eccles. I am speaking of the Thomas amendment.

Senator Tobey. I am speaking of the danger of inflation. Now it is almost a stark reality.

Mr. Eccles. Yes, but you had not spent much in those days.

I hope, Senators, that this bill may be reported out, and that we may get it pretty soon, because I think it is an urgent matter, so that we can actually go out and make a drive on these banks to get these war loan accounts opened for the drive.

The CHAIRMAN. Very well. If there is nothing further, gentlemen, we will take up S. 677.

(Whereupon, the hearing on S. 700 was concluded.)

(The following letter was submitted by the American Bankers Association for inclusion in the record.)

THE AMERICAN BANKERS ASSOCIATION,
New York, N. Y., February 17, 1943.

Hon. ROBERT F. WAGNER,
Chairman, Senate Committee on Banking and Currency,
United States Senate, Washington, D. C.

DEAR SENATOR: Your committee has before it today S. 700. The purpose of this legislation is to exclude from the definition of "deposit," for the purpose of determining the assessment base of the Federal Deposit Insurance Corporation, all Government funds arising solely as a result of subscriptions made by or through an insured bank for Government securities issued under authority of the Second Liberty Bond Act, as amended. If this legislation is adopted, it will be effective only during the war and for 6 months after cessation of hostilities.

The enactment of this legislation will be somewhat beneficial during the period of the war to those banks having war loan accounts. The American Bankers Association has considered this legislation and desires to express to you its approval thereof as a war measure.

The 15,000 banks in the Nation are practically all members of the Federal Deposit Insurance Corporation, there being only approximately 1,350 banks which are not members of the Corporation. There is a unanimity of opinion among these insured banks that an immediate need exists for certain basic changes in the law creating the Federal Deposit Insurance Corporation.

If agreeable to you and the members of your committee, the association would like the privilege at some time in the near future to discuss with your committee certain amendments to the Federal Deposit Insurance Corporation Act which this association believes should be made by Congress. It is hoped to have these suggested amendments in legislative form within a reasonable period of time so that they can be submitted to you and your committee for consideration.

Yours truly,

A. L. M. WIGGINS,
Chairman, Committee on Federal Legislation.