

Governor Eccles

JANUARY 1951 ECONOMIC REPORT OF THE PRESIDENT

HEARINGS

BEFORE THE

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THURSDAY, JANUARY 25, 1951

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The joint committee met, pursuant to adjournment, at 10 a. m., in room 362, Old House Office Building, Senator Joseph C. O'Mahoney (chairman) presiding.

Present: Senators O'Mahoney (chairman), Taft, and Flanders; Representatives Wolcott, Patman, and Buchanan.

Also present: Representative Henry O. Talle; Theodore J. Kreps, staff director; Grover W. Ensley, associate staff director; Fred E. Berquist, minority economist; and John W. Lehman, clerk.

The CHAIRMAN. The committee will come to order.

Mr. Eccles, are you ready to proceed?

Mr. ECCLES. Yes.

The CHAIRMAN. Just introduce yourself first, on the record. We all know you, but we want the written record to show.

Mr. PATMAN. Mr. Chairman, may I inquire about the program for today. You expect to have Mr. Eccles this morning?

The CHAIRMAN. That is right.

Mr. PATMAN. And this afternoon?

The CHAIRMAN. Mr. Eccles is the only witness for today. The next session will be tomorrow afternoon at 2 o'clock, when Mr. Eric Johnston will appear, followed at 3:30 by Mr. Wilson. The meeting on Friday will be in this room, beginning at 2 o'clock.

Mr. PATMAN. I was thinking they were on this afternoon. It is tomorrow?

The CHAIRMAN. It is tomorrow.

STATEMENT OF MARRINER S. ECCLES, MEMBER, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Mr. ECCLES. Mr. Chairman, I am a member of the Board of Governors of the Federal Reserve System. In appearing before you today, I am speaking for myself and not officially for the Board.

The CHAIRMAN. I might say that the committee invited Mr. McCabe, but due to his absence from the city and his illness he was unable to appear today.

Mr. ECCLES. Yes.

I have a prepared statement which, if I may do so, I would like to read through, and, if it is possible to do so without interruption, I would appreciate it. I will then be glad, of course, to submit to such interrogation as the committee may want to make.

The CHAIRMAN. That will be agreeable, without objection.

Mr. ECCLES. Mr. Chairman and members of the committee, I appreciate this opportunity to appear before your committee in its hearings on the problems of controlling inflation.

Our defense-preparedness program must be designed to prevent war and to prevent inflation, while at the same time preserving the essential freedoms of our democratic institutions. It must also be sustainable for an indefinite period of time. If we fail to make these aims our major goals, the very system which we are trying to maintain will be destroyed. This means we must adopt a realistic foreign policy—one which recognizes the limitations of our resources and manpower, and one which we can pay for currently.

How can we best, within this framework, protect ourselves, maintain our essential economic and democratic strength, and at the same time fulfill our commitments to help defend and protect the other free countries of the world? I believe to do this we must limit our aggregate expenditures on our defense and foreign-aid program to a maximum of \$50,000,000,000 annually. This we can pay for currently given a total national product of some \$300,000,000,000, the estimated amount for the next fiscal year. This money must be used in such manner as to assure the maximum military effectiveness of ourselves and our allies, which means a program most likely to prevent war.

We must recognize the fact that Russia occupies or controls the greater part of the tremendous land mass of Europe and Asia. This land mass has a population of nearly a billion people, and great material resources, and is far removed from our own shores. We can never expect to defeat Russia on land. We would be bled white and destroyed, economically as well as militarily, by any attempt to do so. We cannot hope to be prepared to supply or maintain ground forces at every strategic point around the 20,000-mile periphery of the Communist Empire. We cannot be prepared on the ground to meet attacks at the time and place selected by Russia.

There are, however, decisive things we can do with our superior technology and scientific know-how, and within the limitations of a budget we can pay for. We can, with the assistance of the British Empire and such cooperation as other free nations are willing and able to give us, rapidly establish overwhelming control of the air and the sea. From strategic air and naval bases throughout the world, protected by adequate ground forces, we can threaten swift retaliation with atomic and our other destructive weapons if Russia undertakes aggressive action.

We should recognize the facts that our unrivaled productive capacity is our strongest line of defense; that our ability to produce is largely determined by our available manpower, and that our country is the arsenal of the free nations of the world and must not be weakened by a military program which we cannot maintain indefinitely without regimentation or inflation, or which leads to war. We should keep our Ground Forces as small as possible so as to maintain our production at full strength to meet our civilian and military needs and help the other free nations to arm their available manpower and build up their defenses. Our manpower can contribute far more to the defense of the free world in our production lines, in our Navy and Air Force, than in the front lines of land armies in Asia or Europe.

We should quickly arrange a peace treaty with Japan and Western Germany, bringing them into the United Nations and helping them

and other friendly countries, including Spain, to rearm as quickly as possible so as to be able to deter, or resist if necessary, aggression by China, Eastern Germany, or other Russian satellites. Our present military forces should be maintained in Germany and Japan until they have fully rearmed for defense. Neither they nor the other free countries can be expected to resist successfully direct attacks by Russia. The addition of such land forces as we could send, and at the same time maintain our supremacy on the production line, and in the air, and on the sea, cannot be expected to provide the balance of power necessary to deter, contain, or defeat the Russians.

Russia should know that direct attack by her would mean war with the rest of the free world—war in the air, on the sea, and on the land, involving atomic and all other weapons of destruction. This threat of world-wide total war will, I believe, deter the Soviet Union, because it would mean her destruction as well as that of her enemies. A world war would be an atomic war or worse, a war that could not be won by any nation or group of nations, a war that might mean the destruction of civilization. For that reason, we should not think or talk of war as being inevitable. We can, I believe, by the plan I have outlined, make it so costly for Russia to start war that she will not dare attempt it.

Under the protection of American and British air and sea power the free nations on the periphery of the Soviet Empire can rapidly rearm with the great help we can give them from our production lines.

We should not attempt to rebuild great military strength in either Germany or Japan for possible war with Russia. Russia may not be willing to tolerate the reconstruction of great military forces of Western Powers on her borders any more than we would if our positions were reversed. I do not believe Germany or Japan will be parties to such a program. It would seem that they do not propose to be the battleground for the defense of the Western World. I believe we must plan on Germany and Japan developing as defensively armed neutral areas between the Communists and the Western World.

War can be avoided, I believe, if we do not attempt to build up international competitive and threatening military forces in Japan or on the continents of Europe or Asia. Any attempt to do so is likely to provoke aggression. Great standing armies cannot be mobilized, facing each other for long periods of time, without war. In any case, what is the stopping point of expansion and how do you ever demobilize them?

We should not make any commitment to use the atomic bomb only if it is used against us first. Such a commitment offers us no protection. We must retain the initiative for use of all our weapons, including the atomic bomb. Any defense-preparedness program may mean an uneasy peace, but it will be as uneasy for the Russians as for us.

I should like now to discuss rather fully the inflationary problems of defense as related to fiscal, monetary, and direct controls.

The CHAIRMAN. Mr. Eccles, since you have devoted this portion of your talk to foreign policy and you are now——

Mr. ECCLES. The economic aspects of it.

The CHAIRMAN. I think it is much more than that.

Now you propose to go to the economic phases of it. I am sure you won't object to questions on this first part?

Mr. ECCLES. All right.

The CHAIRMAN. I am wondering how you reconcile two statements which I find here in your prepared testimony. On page 2, in the second paragraph, you say [reading]:

Our present military forces should be maintained in Germany and Japan until they have fully rearmed for the defense.

That, I take it, means that, in your opinion, we ought to keep our present military forces in Germany and Japan until Germany and Japan have fully rearmed for defense?

Mr. ECCLES. That is right.

The CHAIRMAN. Then, on the same page, at the beginning of the second paragraph from the bottom of the page, you say [reading]:

We should not attempt to rebuild great military strength in either Germany or Japan for possible war with Russia.

Mr. ECCLES. That is right.

The CHAIRMAN. Which of these two contrary positions do you really take?

Mr. ECCLES. I don't think they are contrary.

The CHAIRMAN. In the first sentence you say we must keep our troops in Germany and Japan until Japan and Germany are fully rearmed for defense. In the second you say we should not attempt to rebuild great military strength in either Germany or Japan.

Mr. ECCLES. There is a great difference between rearming Germany and Japan to defend themselves and placing in Germany and Japan international armies of the United States, Britain, and other countries.

It seems to me that Russia should not object to Western Germany rearming herself for her own defense, in the same manner that Eastern Germany has rearmed herself. Such defensive rearmament would simply mean that Eastern Germany could not go through Western Germany without some resistance.

The CHAIRMAN. Do you think—

Mr. ECCLES. It seems to me that a threat of an offensive war, or an invasion of the Soviet Empire, is not likely, and Russia would not expect it to be likely, if Western Germany had only such military forces as would enable it to defend itself against Eastern Germany or other Russian satellites.

The CHAIRMAN. Do you think that the Kremlin understands the difference between the two as you define them?

Mr. ECCLES. I think it would make a great difference.

The CHAIRMAN. I know you do, but do you think Russia would think so?

Mr. ECCLES. I would think so.

The CHAIRMAN. Then, let me direct your attention to two other sentences. I refer to page 1, the last sentence in the second paragraph from the end [reading]:

From strategic air and naval bases throughout the world, protected by adequate ground forces, we can threaten swift retaliation with atomic and our other destructive weapons if Russia undertakes aggressive action.

I take that to mean "retaliation," which is the word you used?

Mr. ECCLES. That is right.

The CHAIRMAN. And I take it it would depend on whether or not Russia takes the initiative; right?

Mr. ECCLES. That is correct.

The CHAIRMAN. Then, on page 3, you say, in the second paragraph from the end [reading]:

We should not make any commitment to use the atomic bomb only if it is used against us first. Such a commitment offers us no protection.

Do you believe that we should retain the initiative and be in a position to use the atomic bomb first, or do you believe that we should use it only in retaliation, as you first said?

Mr. ECCLES. Well, it seems to me that we should make no commitment. I would certainly feel that we should not use it except in retaliation, but retaliation by the use of the atomic bomb may not necessarily mean after Russia had used the atomic bomb. We should be free to use the atomic bomb in retaliation for an attack by Russian forces on Western Germany, on Turkey, or on other areas around the periphery. The Russians might not use the atom bomb, but it seems to me that if Russia undertakes to invade free countries around her periphery, that we have little or no choice except to go to war with Russia and use whatever we have. It seems to me that, if Russia well understood this, it would be a sufficient deterrent. I don't think that we should promise Russia that if she undertook to invade areas of the free world with her troops we would not use certain of our weapons. We might not use them, but I don't think we should give her that security. Our promises are usually pretty dependable, whereas we have found her promises are not dependable, and if a promise by us were to guarantee us—

The CHAIRMAN. I agree with you on that. I feel, however, that neither you nor I have heard of any proposal to make any promise to Russia with respect to the use of weapons.

However, we have come now to the basic question, and that is the subject which you are going to discuss. You have stated here, in your opening review of foreign policy, that you believe we must limit our aggregate expenditures on our defense and foreign-aid program to a maximum of \$50,000,000,000 annually. Therefore, the question is, as I see it, whether an expenditure of that magnitude can be maintained over a long period of years of preparation and at the same time retain, as you say we ought to retain, and I think everybody agrees we should retain, our essential freedoms and our democratic institutions. I assume that that will be the subject of the rest of your paper.

Mr. PATMAN. Mr. Chairman, I would like to ask one question.

The CHAIRMAN. Yes.

Mr. PATMAN. Does this \$50,000,000,000 you mention here compare with the \$71,000,000,000 budget we are proposing this year, or at least that the Budget Bureau is proposing?

Mr. ECCLES. That would depend upon the amount of nondefense and foreign aid that was included in the budget.

Mr. PATMAN. I know, but let's—

Mr. ECCLES. That would allow \$21,000,000,000 for everything else.

Mr. PATMAN. Would allow what?

Mr. ECCLES. \$21,000,000,000.

Mr. PATMAN. I know you are advocating \$50,000,000,000. Now, are you—

The CHAIRMAN. For two specific purposes.

Mr. PATMAN. Yes. Are you advocating reducing the budget from \$71,000,000,000 to \$50,000,000,000?

Mr. ECCLES. No, no; no, no, no.

Mr. PATMAN. Or defense and foreign aid?

Mr. ECCLES. Defense and foreign aid specifically.

Mr. PATMAN. How much is in the present budget for defense and foreign aid?

Mr. ECCLES. I think that it may be around that figure. The total budget is \$71,000,000,000.

Mr. PATMAN. \$71,000,000,000?

Mr. ECCLES. That is right.

In this connection, I wrote an article for Fortune magazine in September. At that time, after considerable study, I came to the conclusion that, given a \$300,000,000,000 national product based upon the present, the approximate existing price level—

The CHAIRMAN. May I interrupt so as to get these figures straight.

I have before me the budget message of the President. It calls for expenditures for military services of \$41,421,000,000, for international security and foreign relations, \$7,461,000,000; and then, in addition to that, there is the budget estimate for atomic energy—that is included, curiously enough, under the heading "Natural resources," which, of course, includes more than atomic energy—but the fund, the entire fund, for "natural resources" is \$2,500,000,000.

So that actually the budget which has come up to us for actual cash expenditures in 1952, for defense and foreign aid, is only slightly more than \$50,000,000,000. The other is for other services, some of which, of course, are war-connected, like veterans' services and benefits, the estimate for which is \$4,900,000,000. Of course, there is shipping and other general expenditures.

Mr. BUCHANAN. Here is a breakdown summary of the President's 1952 budget, and it totals the estimate for 1952 at \$52,500,000,000. I would assume that you recommend a reduction of some \$2,500,000,000?

Mr. ECCLES. Well, I think—

The CHAIRMAN. I thought he was thinking in round figures.

Mr. ECCLES. I am thinking in terms of the total budget as well as the other; only time wouldn't permit going into all of it. But the main issue of today, of inflation, has developed because of the large defense-preparedness program. Therefore, it seemed to me that we should start with the basis of our problem; to determine what our foreign policy would need to be if we were going to stay within the framework of a \$50,000,000,000 budget.

What concerns me is not the immediate budget figures. However, based upon my experience in Washington over a great many years, I have observed how budgets, especially in the military and the foreign-aid fields, can grow, and how deficiency appropriations have to be made. What seems to me may well develop, if our whole foreign policy is not designed within the framework of a \$50,000,000,000 budget, is that we may find that either we can't control inflation or that we will be so regimented that we will lose everything that we are fighting for.

That is why I took the time to discuss foreign policy, because it is basic to our problem.

The CHAIRMAN. Let me put the question this way: It has been estimated that during World War II, at the height of our military

effort, we were devoting between 40 and 50 percent of the gross national product to war; that last year we were not devoting more than 7 percent of the gross national product to defense and foreign commitments, and that in the present budget it probably will reach 18 to 20 percent. The question, therefore, is, What portion of our gross national product can we safely, without inflation and regimentation, devote to military expenditures and foreign aid, and how much of our normal activity must we be prepared to maintain so that these other efforts can be carried on?

Mr. ECCLES. That is just exactly the problem that we are confronted with. That is why I have thought so much about what we can do in the foreign field without destroying the very system that we are trying to protect. It seems to me that we are entering upon an international program that really has no terminal point, and that manpower is the most important element in our economic problem today. It therefore becomes a question of how best to use that manpower to carry out our purposes, which is what I have been trying to cover here.

It seems to me that we can design a foreign policy that will fit within the framework of a \$50,000,000,000 budget, and secure the greatest protection for us, as well as the greatest protection for the rest of the free world. Now the question is, how do we raise such a budget, and how do we prevent inflation within our domestic economy, given a total budget of from 70 to 75 billion dollars? Nondefense expenditures cannot, in my opinion, be reduced under any circumstances, below \$20,000,000,000. They have been running at \$25,000,000,000, and if they are reduced by \$5,000,000,000 it will be quite an achievement.

If I may proceed, Mr. Chairman—

The CHAIRMAN. Yes. If you will excuse our interruption. I thought that it came at the proper time. You are now at liberty to proceed with the economic discussion without interruption until you have finished.

Mr. ECCLES. Thank you.

WHY BALANCE THE BUDGET?

We shall lose the fight against totalitarianism, even though our military and foreign policies are successful in maintaining peace, if we permit inflation to sap the strength of our democratic institutions. Inflation is an insidious thing. In its early stages it can have a certain exhilarating effect. But as it proceeds it will operate to destroy our free economy. Inflation works a grave injustice on great masses of people. It injures most the aged, the pensioners, the widows, and the disabled, the most helpless members of our society. It diminishes the desire to work, to save, and to plan for the future. It causes unrest and dissension among people and thereby weakens our productivity and hence our defense effort. It imperils the existence of the very system that all of our efforts are designed to protect.

We must recognize that our problem of controlling inflation is more complicated now than in World War II. There is no end in sight for the necessity of maintaining very large Government expenditures, even though nondefense expenditures are reduced to the very minimum, as they certainly should be. People hold an unparalleled

amount of liquid assets in the form of bank deposits, Government bonds, equity in insurance policies, building and loan shares, and other forms. Potentialities for inflation are now tremendous. It would be impossible to prevent inflation under these conditions without at least balancing the Federal budget.

Everyone will agree that our military and foreign aid program will divert large supplies of goods and services from private consumption and investment. This is a physical fact that will not be changed whether or not we tax ourselves to pay for it. The production of the goods and services for this program will provide money income to those who are engaged in it, but it will not provide a corresponding volume of goods or services for which this income may be spent.

Without a pay-as-you-go tax program the Government will have to borrow to make up its deficit, either from the banks or from the non-banking public. Although borrowing from the public is less inflationary than from banks, there is no assurance that such borrowing could succeed in soaking up the excess funds available for spending. In my judgment, it would be impossible to avoid destructive inflation and further debasement of the dollar if the policy of an unbalanced budget, however financed, were long continued. An over-all complete harness of controls would only postpone the disastrous consequences.

Borrowing from banks creates new money. Borrowing from non-bank sources does not increase the money supply, but it adds to the total volume of the public debt and to the liquid assets held by the public, thus storing up inflationary pressures for the future under present debt-management policies. The money supply is already excessive, considering the fact that it is being used less actively than it could be, compared with past experience. In addition, the tremendous amount of other liquid assets held by the public is like money in many respects because it can be turned into money under the present Federal Reserve policy of supporting the Government security market at fixed prices and interest rates.

As inflation proceeds, the desire increases to convert liquid assets into money and then into goods and services. This is what is known as the flight from the dollar. The need to hold money and other liquid assets is not as great today as it has been in the past. This is because of improved insurance and pension provisions for old age. Also—the urge to provide for the contingency of depression and unemployment is less compelling. Under these circumstances the more liquid assets the public holds the more likely they are to cash them and spend the proceeds. Thus you can have an inflation even if all Federal deficit financing is done outside the banks.

HOW TO RAISE TAX REVENUES

There can be no escaping the fact that a pay-as-you-go tax program will increase the tax burden of all who receive more than a subsistence. We will have to get the money from those individuals and businesses who receive it in relationship to the Government's need and their ability to pay. In this country income and financial resources are broadly distributed. Tax increases to raise \$16,000,000,000 will likewise have to be broadly distributed.

An increase in individual income taxes should produce about half of the additional revenue required. Since the bulk of the taxable income is in the first taxable bracket, the increase will have to begin there, starting say with a rate of 25 percent instead of 20, and go all the way up the income scale. There should be an increase in the regular corporation income tax with some credit allowance on that part of income which is disbursed as dividends, these being subject to individual income taxes. We should also greatly strengthen the new excess-profits-tax law. Excise taxes should be placed on all non-essential goods now exempt and increased on nonessentials now subject to tax.

With the proposed increased tax rates on individual and corporate incomes, it is especially essential that all loopholes in the tax laws be closed. This source alone might provide as much as \$3,000,000,000 in additional revenue. Exempt income of insurance companies, savings and loan associations, and farm, labor, educational, and religious cooperatives, as well as interest from new securities of State and local governments, should be taxed. Depletion allowances should be greatly reduced in accordance with Treasury recommendations, and unusual expenses and promotional and advertising outlays made nondeductible for tax purposes. And there are other loopholes that should be closed. The present capital-gains tax is one of these loopholes for tax avoidance. It also promotes inflation, particularly in commodities, real estate, and stocks.

To maintain the morale of the taxpayer who pays his honest share of taxes, loopholes must be closed and tax enforcement intensified. The Treasury should have sufficient competent personnel to give the same strict enforcement of tax collection to farmers, professional people, and the small unincorporated businesses as is now applied to other types of taxpayers, notably those whose entire income is subject to withholding taxes.

CREDIT RESTRAINTS NEEDED

No tax program by itself is sufficient to prevent inflation under the conditions we face. It must be backed up by restrictive credit and monetary measures. Many individuals and corporations, when their expenditures are squeezed by higher taxes, will try to supplement their incomes by borrowing. Other credit demands will continue as there is an increasing effort to borrow to build up inventories, particularly of scarce goods, to take advantage of investment opportunities, and to speculate on the inflationary rise. The harm to our economic stability from such private deficit financing is at least as great as that from deficit financing by the Government. In fact, the whole postwar inflation, and particularly since the Korean outbreak, has been due to private rather than Government deficit spending. If we impose painful taxes to avoid one form of deficit financing we must surely seek out a way to put a check on the other.

To prevent inflation we must stop the over-all growth in credit and the money supply whether for financing Government or private deficit spending. The supply of money must be controlled at the source of its creation, which is the banking system. Under our present powers, the only way to do this is by denying banks access

to Federal Reserve funds which provide the basis for a sixfold expansion in our money supply. The only way to stop access to Federal Reserve funds is by withdrawing Federal Reserve support from the Government securities market and penalizing borrowing by the member banks from the Federal Reserve banks. As long as the Federal Reserve is required to buy Government securities at the will of the market for the purpose of defending a fixed pattern of interest rates established by the Treasury, it must stand ready to create new bank reserves in unlimited amount. This policy makes the entire banking system, through the action of the Federal Reserve System, an engine of inflation.

If access to Federal Reserve credit were strictly limited or denied, and if there were more sellers than buyers of Government securities, then prices of outstanding Government securities would decline and interest rates would rise until the market became self-sustaining. More sellers of Government securities than buyers indicates that the public is not willing to hold at existing rates. The only way to restore the balance is to let interest rates go higher to meet public demands. The Government with the support of the Federal Reserve has the machinery and the power to decree what prevailing interest rates are to be. But lacking the power to require the holding of its securities by the public, the Government cannot prevent their being offered for sale if the public is not willing to hold at those rates. If interest rates are not to be allowed to rise in response to market forces, then the Government must create all the money it takes to keep rates down. This in effect makes interest-bearing money out of all Government securities and adds to the liquidity of all private debt as well. It is hard to conceive of a more inflationary monetary policy.

There is another aspect of an interest-rate freeze that under present conditions works to promote expansion of our money supply. Interest rates on short-term Government securities are about half of what rates are on long-term issues. Corporations and other nonbank investors hold short-term securities, however, because they do not wish to take the chance of a market loss on long-term issues should they need their funds. But if the policy as announced by the Secretary of the Treasury is to prevail, that the existing pattern of interest rates will not be allowed to rise, then long-term Government bonds in effect become demand obligations. The lower yielding short-term securities held by nonbank investors will be shifted to the Federal Reserve. This process generates demand for long-term Government securities, helps to maintain a lower long-term rate than would otherwise prevail, and gives the appearance of tremendous success to each Government financing effort. It is however, a success bought by the creation of tremendous sums of money, at the cost of progressive decline in the value of the dollar.

To allow interest rates on Government securities to respond to the forces of the money and credit market, I realize, raises problems of debt management because of the large volume of debt maturing each year and the demand liabilities in savings bonds. With large and frequent refundings, the process of permitting interest fluctuations involves careful management. If a refunding offering is not in line with market rates, Federal Reserve support is necessary to insure its success.

These are important problems which a frozen pattern of interest rates can avoid. But they are not nearly as formidable as the problems that we take on if we accept a frozen interest-rate structure. We cannot prevent increases in the volume of our money if we are unwilling to deny Federal Reserve credit when inflation is taking place, and to allow interest rates to rise if market forces operate in this direction. Inflation and debasement of the value of the dollar is the price we pay for the luxury of a booming Government securities market. Any tax program we are likely to adopt can hardly be adequate to stop inflation in the long run as long as the money and credit flood-gates are left open.

If the Federal Reserve is to be required to maintain a fixed pattern of interest rates established by the Treasury, then the System should either be discharged of its responsibility for controlling the volume of credit and money or be given new powers as partial substitutes for those that it is not permitted to use. The limited selective controls which the System now has over certain consumer, real-estate, and stock-market credit may be useful and desirable, although their effectiveness is certainly much more limited than is generally believed. Authority to increase reserve requirements of all commercial banks would be a partial substitute for traditional credit-control powers to enable the System to immobilize new bank reserves arising from its purchases of Government securities in support of the market. Authority would also be needed to require all commercial banks to hold an adequate percentage of their deposits in a special reserve in Government securities, or at their option a like amount in cash. It would likely be essential for the Federal Reserve to have authority to require savings institutions, such as life-insurance companies, savings banks, and savings-and-loan associations, to hold a certain proportion of their assets in Government securities in order to prevent them from selling in a market supported at pegged prices by the Federal Reserve.

All of these substitute powers would be necessary to compensate for the control over expansion in our money supply that we give up when the interest pattern on Government securities is frozen.

SELECTIVE PRICE AND WAGE CONTROLS

Fiscal and credit action will have to be buttressed for the present with some rationing and allocations. They will be required to control the use of certain essential goods in short supply and of scarce or critical materials and finished products. To prevent the bidding-up of prices on these items, price controls will be needed. Such controls should be selective, however, and applied only in those limited cases where materials or goods are both essential and in short supply, and removed as soon as they are no longer in short supply or deemed essential.

Over-all price controls are unnecessary and should not be imposed upon the economy. Price controls cannot be successfully applied unless simultaneously accompanied by allocation and rationing. Price controls alone merely lead to black markets and racketeering, profiteering, and tax evasion. We know from past experience that even during war a comprehensive harness of direct controls unsupported by adequate fiscal and monetary policies did not prevent inflation,

but only concealed and postponed the inflationary results. They deal with the effects rather than the causes—they sugar-coat the inflation, so that the public's will to accept the required taxes and credit restraints is weakened and destroyed. There is no substitute for adequate fiscal and monetary measures; with them, the need for direct controls is reduced to a minimum.

One of the worst features of trying to enforce a comprehensive harness of direct controls is that it so regimenta the entire economy as to destroy our essential freedoms. It requires the establishment of a huge bureaucracy for policy making, administration, and policing—a most uneconomic utilization of an already short supply of manpower. This cannot be justified. Worst of all, such regulation and regimentation, undertaken for any extended period of time, will prove so intolerable that public revulsion will lead to withdrawal of essential support for a program necessary to defend the free world, prevent war, and assure the preservation of the value of the dollar.

Even though I have strongly opposed a general price freeze for the reasons stated, I still feel that it is essential that wage and salary ceilings be put into effect promptly. On an over-all basis, prices are made up largely of wages and salaries, and prices cannot be kept down with continuing increases in wages and salaries. Labor should not object to wage and salary ceilings, so long as any excess profits of corporations are drained off through taxation.

Another reason for a wage freeze is that higher personal income taxes required to balance the budget will reduce the hourly take-home pay of labor, as they must do if they are to be effective. Union leaders are likely to press demands for higher wages to offset this reduction in take-home pay and to maintain labor's standard of living. To grant such wage increases would entirely defeat one of the major purposes of increased taxes, viz, the curtailment of purchasing power at a time when there is a scarcity of many civilian goods. Finally, due to the shortage of labor, employers, especially those subject to high excess profits taxes, will bid employees away from each other.

Not only should wage and salary ceilings be imposed, but all fringe benefits, including bonuses and pensions, should be rigidly curtailed. Escalator clauses should be excluded from all future wage contracts—they are built-in inflationary devices.

A 44-hour week, without overtime rates of pay should, I believe be generally adopted for the purpose of increasing total production and helping to maintain the standard of living without increasing costs. Increased production is, in the end, the primary solution to the inflation problem, provided it can be brought about without increasing costs and purchasing power more rapidly than the supply of goods.

Labor should be willing to accept wage ceilings and a longer work week at a time when both are so essential to the prevention of further inflation. After all, the defense of the dollar is more vital to labor than to almost anyone else.

CONCLUSION

In conclusion, let me repeat that a successful preparedness defense program must prevent war and must not lead to destructive inflation. Total war, with atomic weapons, would mean victory for none and

destruction for all. Regimentation or further inflation, even if war is avoided, will ultimately lead to the destruction of our capitalistic democracy. Therefore, our foreign policy must be designed on the basis of what we can pay for currently, and our fiscal program must be supported by restrictive monetary and credit policies, together with only such limited direct controls as the situation may require.

The CHAIRMAN. Mr. Eccles, may I ask you to turn to page 2 of this section of your discussion, to that portion of the paper which is headed "How to raise tax revenues." In the first paragraph under the heading "How to raise tax revenues," you say [reading]:

We will have to get the money from those individuals and businesses who receive it in relationship to the Government's need and their ability to pay.

I refer particularly to the clause "their ability to pay." Does that mean that you favor an income tax on corporations as on individuals, the size of which will be related to the ability of the corporation to pay?

Mr. ECCLES. I favor an excess profits tax.

The CHAIRMAN. Well, the reason I ask—

Mr. ECCLES. Which seems to me to be very closely related to ability to pay.

The CHAIRMAN. Yes, but then you also have said, in the next paragraph [reading]:

There should be an increase in the regular corporation income tax with some credit allowance on that part of income which is disbursed as dividends, these being subject to individual income taxes.

There has been some difference of opinion among financial experts in the fiscal centers, at least those that have talked with me, as to whether or not the income tax on corporations should be at a limited rate, that is, the regular and the surtax should be limited, say, at 45, 55, or whatever, so that corporations with a taxable income of \$100,000, and the corporation with a taxable income of a million dollars, would be limited to 45, 47, 55, or whatever the rate might be, regardless of ability to pay.

Have you given that question any thought?

Mr. ECCLES. Yes, I have given it considerable thought.

The CHAIRMAN. It has been suggested to me that unless the ability to pay formula is followed the result will be very discouraging to smaller corporations and very encouraging to the expansion of larger corporations.

Mr. ECCLES. If that isn't followed you are not likely to follow the money where it goes. After all, if you are not going to create new money you have got to collect and redistribute the money where it is.

Now, our utilities are examples of concerns which are seldom in what you would call the excess profits bracket. They are concerns which largely pay out most of their income. They are concerns that have to use the capital market to raise large sums of money, largely through bonded indebtedness. Their earnings, net earnings, are comparatively small, in relation to their total capital investment—4, 5, 6 percent, after taxes.

If the normal tax and the surtax, are substantially increased, they may well have to have an increase in their rates, which in itself would be inflationary, in order to be able to maintain the value of their securities, so that they could refund and finance.

It doesn't seem to me that a concern that pays out practically all of its earnings, of which the Government recaptures a large part through surtaxes on individuals, should necessarily pay the same rates as those companies that pay out little or none of their earnings. There are many companies that take advantage of the tax structure for the purpose of avoiding the payment of surtaxes by individuals.

Now, the thought I have in mind is that instead of increasing the normal tax and the surtax from 47 percent, which is pretty high, to say 55 or 60 percent, and having no excess profits tax, it should be increased only slightly to 50 or a maximum of 55 percent, and there should be some credit, maybe 10 or 15 percent, for what is disbursed in dividends.

The CHAIRMAN. My question was whether or not there should be the same measure for all corporations, little and big, assuming an over-all 55 percent rate of normal and surtax. Would you recommend that, or would you recommend a rising scale according to ability to pay?

Mr. ECCLES. I don't think that ability to pay is related necessarily to size. I know a great many—

The CHAIRMAN. I mean size only in the amount of income.

Mr. ECCLES. Yes, but I know a great many of what we speak of as small companies, whose return on net worth is very, very high—

The CHAIRMAN. Oh, sure.

Mr. ECCLES (continuing). And which are owned by very few people. They disburse no income, but use their earnings to go out and expand, very often in speculative fields, in order that their owners may avoid the payment of surtaxes.

Senator TAFT. That is more often the case in intermediate companies than it is in big companies.

Mr. ECCLES. It is because they are under the control of fewer people.

The CHAIRMAN. I am not attempting to argue that point, I am merely trying to clarify your statement, and your statement is, we will have to get the money from those individuals and businesses who receive it, in relationship to the Government's need, and their ability to pay. I merely wanted to know whether you relate that phrase "and ability to pay" to businesses as well as to individuals, and to incorporated business as well as nonincorporated?

Mr. ECCLES. Yes, I do.

Senator FLANDERS. May I ask the question in slightly different words?

The CHAIRMAN. Yes.

Senator FLANDERS. I take it that what the chairman has in mind is to ask, Do you believe in a sliding scale for taxation of corporations?

Mr. ECCLES. No; I do not. I think that that would be very inequitable.

The CHAIRMAN. Then you didn't mean to use the phrase "ability to pay"?

Mr. ECCLES. Oh, yes; I did.

The CHAIRMAN. As to corporations?

Mr. ECCLES. I did; very definitely. I don't think that ability to pay is necessarily related to a sliding scale. It seems to me that a small concern making 20 percent on its capital has more ability to pay than a large one making 10 percent.

The CHAIRMAN. The point is that with the individual income tax the sliding scale runs up to very high limits, and may run higher. Now, are you recommending to this committee that there should be a sliding scale, to adopt Senator Flanders' phrase, which is a very great improvement on my question, Do you mean to apply the sliding scale to individuals, but not to corporations?

Mr. ECCLES. I would not apply the sliding scale to corporations because I do not think that the cases of the individual and the corporation are comparable. The corporation may be composed of a great many small individuals with very little income. Therefore, it seems to me that the corporation, whether it be large or small, should pay the same tax rate, based upon its earnings—either its invested capital or its base period earnings, in the case of the excess profits tax.

It seems to me that there should be some encouragement, if corporation normal and surtaxes are to be increased, to corporations disbursing their dividends, so that the Government will collect substantially more taxes from the individual than it does under existing conditions.

Many corporations have, in the past, been paying out only about a third of their earnings in dividends, some of them have been paying practically nothing, while others have been paying practically everything. There is no recognition of that fact.

Now, with reference to small companies, I do favor giving some exemption before the excess profits tax is applied. We should continue to offer them some exemption before the surtax is applied. I think that we must recognize that in many ways small companies suffer certain disadvantages and need to be encouraged. I would do it, not by different tax rates, but with an exemption prior to the application of a surtax, and a larger exemption prior to the application of an excess profits tax.

That will help a great many companies that do not have the same access to capital as the larger ones. I would get at it that way.

The CHAIRMAN. I note that you recommend improvement in the excess-profits tax and you recommend the closing of loopholes, on a very broad scale.

Mr. ECCLES. I think we have left plenty of them.

The CHAIRMAN. I will defer any further questions of mine until other members of the committee have had an opportunity.

Congressman Patman.

Mr. PATMAN. I will pass.

The CHAIRMAN. Congressman Wolcott.

Mr. WOLCOTT. I will pass.

The CHAIRMAN. Congressman Buchanan.

Mr. BUCHANAN. On page 1 of your statement, regarding selective price and wage controls, would you say that the selective controls enacted, Mr. Eccles, have been effective so far since June of 1950?

Mr. ECCLES. I don't think we have had any controls. I think that—

Mr. BUCHANAN. Would you not regard allocation and priority as a form of control on selective items?

Mr. ECCLES. Well, I think that the controls that we have had have been largely confined to the allocation of certain scarce materials. They have, I think, had some effect, and I think further that there

might well have been further price increases in certain basic products or raw materials, had it not been for such controls.

However, the application and use of controls has been somewhat limited. In the case of steel, copper, lead, aluminum, and certain basic products, I do think they have been effective, and I do think that they are necessary and desirable.

The inflationary situation that developed so rapidly since Korea has been due to a lack of confidence that the dollar is going to be defended and that goods are going to be available. There has been a good deal of forward buying, facilitated by the available supply of money. This inflation has been the direct result of an easy-money policy and a very great and very rapid growth of bank credit—a growth that far exceeds anything that we have ever known at any time. This very rapid growth of bank credit was made possible by an easy-money policy on the part of the Federal Reserve. Through its support of the Government securities market at fixed rates the Federal Reserve has made reserves freely available to banks, and these reserves have formed the basis of the increase in the money supply. This increase in the money supply together with the falling off of savings and the use of existing liquid assets and money, for fear that we were not going to prevent the further cheapening of the dollar, have been the principal factors in the inflationary development.

Mr. BUCHANAN. One further question. You oppose, of course, direct control in the form of regimentation in the entire economy. On the other hand, you advocate a wage and salary ceiling, regimenting that section of the economy, and likewise the advocacy of a 44-hour week. We are also proposing the drafting of 18-year-olds.

How do you reconcile regimenting part of the economy and leaving the profit structure open?

Mr. ECCLES. You are not leaving the profit structure open. You are going to take care of that through the excess-profits tax. That will be a real deterrent to raising prices. The excess profits won't be there.

If this question of price control over the entire economy was practical and feasible of application I would feel very different about it, but I have had too much experience, even during a war period, to be optimistic about its success or its effectiveness. A freezing of prices is not going to be effective without allocations and rationing of the items frozen. It seems to me that to try to freeze prices on hundreds of thousands or millions of items, such as we tried to do during the war, is thoroughly impractical; it requires a regimentation that I don't think this country will stand for long.

What is more, we found that price controls opened the door to black-market operations on a terrific scale. That was particularly true immediately after the war. There was profiteering, tax evasion. The most ardent supporters of a continuation of price control were the black-market operators, just as the bootleggers were the most ardent supporters of prohibition.

It seems to me that to try to control all prices is impractical, and it won't be effective unless you really allocate and ration.

I think you must control prices of the items that are essential, and in short supply, but you must also be prepared to ration and allocate them.

The British never put general price controls on during the war. They weren't concerned about what happened to the prices of luxury items and nonessential goods. There are a great many items that are not in short supply and are not essential. If prices of these items go up they will price themselves out of the market.

There is nothing like prices to control demand.

Mr. BUCHANAN. There is an imbalance now in our economy as a result of the price rise since June of 1950. I wonder how long the economy will stand for wage and salary ceilings.

Mr. ECCLES. I think they won't stand for it at all if prices continue to go up. However, I think that if stiff taxes are enacted and credit expansion is curtailed, you eliminate the principal cause of price increase by taking away from the public the means of purchase. At the same time, you supply the Government with the money to buy the goods that the public cannot buy.

Along with that kind of a tax program you must have a credit-control program. You must not supplement the public income by easy credit.

With such a monetary and fiscal program, with excess-profits taxes that take away the incentive and desire to arbitrarily raise prices, you create confidence in the dollar, you induce people to save their money, and you keep the cost of living down.

The increased hours that are proposed would tend to increase production, would increase the take-home pay along with the increased production, and would help to maintain the standard of living. However, if you give double time, or time and a half, you increase purchasing power more than you do production, thereby defeating the purpose of increased production as a means of curbing inflation.

Mr. BUCHANAN. The difficulty there is that it permits a lag in the price structure before the extra amount of revenue is taken by an increased tax program, when the tax program, and the credit control, fiscal control program takes effect 6 to 12 months later.

Mr. ECCLES. We should get the taxes in very quickly, and should have had credit curbs, adequate credit curbs, before now. They need to be instituted immediately.

So far there has not been a lag in wages and salaries. The opposite has been true ever since the war. The increase in the cost of living has been substantially less than the increase in wages.

For example, the average increase in wages, since 1947, has been 15½ percent, and certainly the increase in the cost of living has been no more than that. Recently the cost of living has exceeded the level of 1948. We reached a high point in the cost of living in 1948, then it went down in 1949, and now it exceeded the 1948 peak.

The CHAIRMAN. It has reached two peaks in the last 6 months, two-all-time peaks, right after Korea and again in December.

Mr. ECCLES. Then went down again.

The CHAIRMAN. It went down again after Korea.

Mr. ECCLES. That is right, the cost of living has just again passed the 1948 peak slightly. During the past few years there have been, as we know, very substantial increases in wages and salaries.

Certainly, at the present time, wage and salary income, has not been penalized in relation to the cost of living. The wage and salary increase in the past 2 years has been substantially more than the increase in the cost of living.

The people who have really been hurt are the fixed-income group, pensioners and other groups of retired persons.

Senator TAFT. The farmers.

Mr. ECCLES. No, with some exceptions.

Mr. BUCHANAN. Unorganized workers groups.

Mr. ECCLES. That is right. The unorganized workers, the white-collared groups, the fixed-income groups, they have really been hurt. They have not been hurt so much during the past 2 years, but they were hurt very severely prior to that time.

Mr. BUCHANAN. That is all, Mr. Chairman.

The CHAIRMAN. I just received word that the radio has announced this morning that the Consumers Price Index for December was formally announced by the Bureau of Labor Statistics as 178.4. In June of 1950 it was 170.2. In November it was 175.6. That is an increase from June to November of 3.2 percent. But the increase from June to December 15, that is to say, 170.2 to 178.4, is an increase of 4.8 percent.

Now, the Consumers Index for 1948 is reported in our Economic Indicators as 171.2.

So that these figures bear out your statement of a very substantial increase in the cost of living.

Senator TAFT. What should be pointed out is that the average hourly wages in manufacturing increased from \$1.23 in 1947 to \$1.35 in 1948, to \$1.51 in November of this year, which is a much larger increase in manufacturing wages, at least, than in the cost of living. The manufacturing increase is somewhat larger than other increases, I think.

Mr. ECCLES. That is right. The total increase in manufacturing wages, as I have it, is 19 percent. In these years, from December 1947 to December 1950, you have had an increase in the hourly pay of 19 percent, whereas you have had an increase in the cost of living of only 6.8 percent.

Senator TAFT. I think it is rather striking that if you take the last year, from November a year ago to November this year, the increase in manufacturing wages was from \$1.39 to \$1.51; the increase in weekly wages was from \$54 to \$62, which is 15 percent, in a year, in weekly wages.

I think your general statement is true enough. Wages, so far as workers are concerned, have probably gone up more than the cost of living, but you do have a large group of people that have not had that increase, of course.

Mr. ECCLES. Well, I don't think there are many. I know a great many cases of unorganized workers and white-collared groups that have had pretty substantial pay increases during the last 2 or 3 years. Competition for their services has been a factor in this respect. I don't think that the average worker, whether organized or unorganized has been seriously hurt by the increase in the cost of living since 1948. He was benefited substantially by the substantial decline from 1948 to 1949, though that benefit has been lost as a result of the recent increase in cost of living. The real injury to the white-collared and unorganized workers was done largely before 1948, during the period 1940-48.

The CHAIRMAN. May I interrupt to say that at this point in the record, in order to clarify the discussion, I think it would be well to

insert the figures which appear in the Economic Indicators for January 1951, on page 3, with respect to consumers' prices, and on page 10, with respect to average hourly earnings in selected industries. I will ask only that the staff bring these figures down to the latest report from the sources.

(The material above referred to may be found in the files of the joint committee.)

Senator TAFT. On this wage question, you are proposing a wage freeze without a price freeze, which I think is a pretty difficult thing.

Mr. ECCLES. It may be.

Senator TAFT. I assume that you would probably admit that if you did that, you would have to permit increases of wages if prices do go up?

Mr. ECCLES. I think so.

Senator TAFT. To take care of the increased cost of living?

Mr. ECCLES. I think so.

Senator TAFT. You wouldn't absolutely freeze wages even though prices continued to go up?

Mr. ECCLES. I agree with that. I certainly do not feel that labor should be penalized, except by taxes like everybody else. I do not think they should be penalized with reference to their hourly wage if prices do go up.

Senator TAFT. That might include an adjustment also of people who had not gotten any increase for the last 3 or 4 years, we will say.

Mr. ECCLES. Well, there would no doubt be some situations where it would result in great inequity and unfairness if they were frozen at wages that they had several years ago.

But this cycle of increasing wages, which in turn increases prices and leads to further rise in the cost of living, which again calls for further wage increases is an inflationary cycle and pattern. It seems to me that you have got to stop the increase in the cost of living by the proper fiscal and monetary policy. You have to induce people to save by maintaining their confidence in the purchasing power of money. If you succeed in this, you will not have this problem of wage increases to meet the increasing cost of living.

There have in the past been too many instances in which wage increases were granted prior to an increase in the cost of living. Such increases were responsible in a considerable measure for the subsequent rise in the cost of living. In the case of those companies with very large profits, it is easy to understand how labor, without thinking of the increase in the cost of living, but only of the ability of the company to pay higher wages, would make demands. It should be realized that with an excess-profits tax in the picture any increase in wages will mean a reduction in tax revenue which the Government needs and which it would collect in excess profits, provided corporations were not required to turn those excess profits into wages.

Senator TAFT. Mr. Eccles, you suggest a tax system. The only figure I noticed as I went by was \$3,000,000,000 of possible loophole. What is your idea of the relative burden of increased income taxes and increased excise taxes? Are you going to divide it equally between them or have you some definite goal to seek in each field?

Mr. ECCLES. Yes; I did have a goal. Before you came in, Senator, I referred briefly to an article I wrote in September—

Senator TAFT. I read the article, in Fortune magazine.

Mr. ECCLES. That is right. The Defense of the Dollar. Of course, time always changes any kind of a program, no matter what it is. However, at that time I estimated that within a year we would have a national product of \$300,000,000,000, and that we could sustain a maximum expenditure of \$75,000,000,000, or one-fourth of the national product, for defense, foreign aid, and our domestic requirements, over an indefinite period of time.

Senator TAFT. That includes Federal only?

Mr. ECCLES. That was Federal only. I figured 5 percent for the States. That is about what it is running. I assumed that there should be no reduction in the \$600 subsistence exemption. To sustain the morale of the people we have to maintain the subsistence exemption, which would amount to \$90,000,000,000. The balance of \$120,000,000,000 represents the amount available for maintaining our present standard of living, our new investment, et cetera.

At that time I estimated that we could reduce the budget figure of about \$25,000,000,000 for domestic purposes by about \$5,000,000,000. I also estimated that, given a \$300,000,000,000 national product and the tax rates that then existed, we could collect approximately \$55,000,000,000. Since then, enactment of the excess-profits tax has boosted the total to close to \$59,000,000,000. This leaves about \$16,000,000,000 to be raised through additional taxes. According to my September estimates, the taxes would have to be increased as follows: Individual income taxes, from \$22,000,000,000 to \$31,000,000,000, an increase of \$9,000,000,000; corporation income taxes, from \$17,000,000,000 to \$23,000,000,000, an increase of \$6,000,000,000.

I think now that the corporation tax will have to be increased more than that, and the individual tax less. The reason for a smaller increase in the corporate tax rate is that I am proposing a credit for the disbursement of earnings. Such a credit, by encouraging dividend payments, would increase the amount of individual income tax revenue from the middle and higher income brackets, who would receive the dividends.

In other words, it reduces the amount of revenue derived from corporation normal taxes and surtaxes because of the dividend disbursement credit. At the same time it would substantially increase the income in the middle and upper income brackets because of the larger dividend disbursements.

If that is not incorporated in our tax laws, then the individual income taxes would be less, and the corporation taxes would be more.

The excise taxes I figured should be increased at least \$2,000,000,000, from about \$8,800,000,000, which is the yield we estimated on the basis of a \$300,000,000,000 national product to \$10,800,000,000.

Social security taxes, given present full employment levels, should provide about \$5,000,000,000.

You see, I am speaking of a cash budget, which is what we must consider.

The matter of how much additional revenue might be raised by closing the loopholes is very difficult to get at. We made the best estimate we could, about \$3,000,000,000.

Then there is some miscellaneous revenue from all other sources which amount to roughly \$2,000,000,000 at the present time and which might increase slightly.

Senator TAFT. The increase in personal income taxes would bear them, say, from 7 to 9, of increase?

Mr. ECCLES. Yes; I would think that they would certainly have to be 6 or 7, I do think that corporation taxes would have to be increased substantially if you do not allow a credit for dividends. There are certainly a lot of loopholes in the excess-profits tax as it now exists. There are other loopholes which I know you men are probably more familiar with than I.

Senator TAFT. Coming to the interest rate, I think we had some figures here on bank loans having increased from December to December by \$7,700,000,000, according to this; the other securities, which is the same kind of thing, by 2 billion in a year; that is 11 billion; and they have apparently sold 4 or 5 billion of Governments to the Federal Reserve to help achieve that increase in loans.

Isn't that a much larger increase in bank loans, bank credit, than we have had for any year for a long time?

Mr. ECCLES. I don't have the figures covering the whole year. Normally there is a seasonal decline in bank credit, during the first 3 months of the year. This year there was practically none during the first several months, which of course, we would consider inflationary by comparison with normal.

The CHAIRMAN. Let me interrupt to say that at this point we can insert in the record the figures from page 30 of the Economic Indicators of January 1951, on bank loans and investments, and money supply from page 31. The staff will bring these figures up to date since the Economic Indicators were published.

(The material above referred to may be found in the files of the joint committee.)

The CHAIRMAN. I hand a copy to you, in case you should happen to need it.

Senator TAFT. Can you tell me offhand how many Government bonds the Federal has had to buy in this year, 1951, for the year 1950?

Mr. ECCLES. Yes; the figure on the growth of loans of all banks, from the beginning of Korea until the end of the year—the period of real inflationary growth of bank credit—is 8.0 billion dollars. During the same period of 1949 the growth in bank loans was only 1.9 billion, while the previous postwar peak was 4.4 billion in 1947. Even during our most inflationary period of 1947-48, the growth in bank loans was less than half what it was during the last half of 1950.

Senator TAFT. Did the Federal have to increase its portfolio of Governments to finance this?

Mr. ECCLES. Yes, we did. That is where it was financed entirely. Since Korea, the banks have decreased their holdings of Government securities by \$4,100,000,000, while the Federal Reserve has increased its holdings by \$2,400,000,000, and supplied that amount of reserves to the banking system. It is on the basis of those reserves that the banking system was able to expand credit. The only way bank credit, which is the source of our money supply, can expand, is by the Federal Reserve System making available Federal Reserve funds, which act as a reserve and are the basis of a 6-to-1 expansion of loans and deposits.

Mr. PATMAN. That 6 to 1 is an average from the biggest bank to the smallest?

Mr. ECCLES. That is right. That is the average. The smallest banks have a 14-percent reserve requirement; the Reserve city banks, 20 percent; the central Reserve city banks, those in Chicago and New York, 24 percent.

It is impossible to stop the growth of bank credit so long as reserves are available to the banks upon call. They are available to the banks upon call so long as the Federal is required to buy securities, Government securities, at the will of the market.

In other words, the control of the flow of bank credit is completely out of the hands of the Federal Reserve System and in the hands of 15,000 bankers.

Senator TAFT. Do you agree with the Treasury's policy of financing the defense effort at present interest rates as announced here the other day?

Mr. ECCLES. I do not.

Senator Taft. I would conclude that from your statement. Can they sell Government securities to investors at the rates that they are fixing, or is it going to force the whole business on the banks?

Mr. ECCLES. Well, there is a serious question as to whether or not they can sell to investors at existing rates. Judging by what has been happening, it would seem that investors are loath to save what they ought to save, and to invest their savings in Government securities, which is very necessary and important. Considering the size of the national product during the past year the amount of savings has been very subnormal. It would seem to me that—

Senator TAFT. You mean that the people are spending money rather than saving it and putting it into savings or Government bonds at existing rates?

Mr. ECCLES. I think on balance that is true, whereas, with national income the greatest it has ever been, there should be an increase in savings.

Senator TAFT. Have more E bonds been turned in than have been sold, do you know?

Mr. ECCLES. Yes; there has been.

The CHAIRMAN. How high would you allow the interest rate to go, Mr. Eccles?

Mr. ECCLES. Well, I think it is a question of the market determining that. It seems to me that if the Federal Reserve denies the market access to Federal Reserve funds, except to the extent necessary to maintain a reasonably orderly market, the price of Government securities would go down and rates would go up, until the sellers, those holding securities, would not be willing to sell at losses, or at existing rates, or buyers would begin to come in. There is some point at which sellers would be deterred and buyers would be encouraged.

The CHAIRMAN. Then your position is that the interest rates upon Government debt should be fixed by uncontrolled and unsupported open market?

Mr. ECCLES. Should be determined by demand and supply. Otherwise you cannot, it seems to me, control the inflationary situation.

The CHAIRMAN. How low should we permit the price of Government securities to fall in such open-market transactions?

Mr. ECCLES. I don't think Government securities would fall substantially, because the minute the banks, insurance companies, and

the other holders of Government securities began to incur losses, it would be very unprofitable for them to sell securities for the purpose of expanding credit. That in itself would be a very important deterrent.

The CHAIRMAN. What was the experience in World War I?

Mr. ECCLES. You can't compare it with World War I. The banks held very few Government securities during World War I; the amount of financing was small and was widely held. The public bought those securities, in many instances borrowing from the banks against the securities. Subsequently, the banks called a lot of the loans which they held which were secured by Government securities, and that forced a heavy liquidation of Government securities.

The CHAIRMAN. And they went down to about 75?

Mr. ECCLES. No; they went down, I think, to about 82. At the present time there is practically no borrowing on Government securities. The insurance companies, the savings banks, the commercial banks, as well as corporations and individuals, are very large holders of marketable securities.

The CHAIRMAN. The experience in World War I resulted, did it not, in transferring Government securities from weak hands to strong hands. As the price went down those who could least afford to hold, sold, and they sold at the lower prices, and those who bought finally got their payments at par.

Mr. ECCLES. The weak hands were those who were borrowing heavily, and that is the way the war was financed. A substantial part of it was financed by getting individuals to buy Governments on the installment plan, and the banks furnished the money.

You don't have that situation today. Government bonds, the marketable securities, are held in very strong hands; they are held by corporations, insurance companies, savings banks, and commercial banks. The rank and file of the public hold, largely, the E, F, and G bonds.

The CHAIRMAN. What would you do with the E bonds? Would you maintain their redemption at par?

Mr. ECCLES. Oh, yes, you couldn't stop that. You would have to retain their redemption.

The CHAIRMAN. What types of securities would you allow to be priced in the open market?

Mr. ECCLES. Marketable securities. The Federal Reserve does not have to support the E, F, and G bonds. They are demand liabilities. But there is a penalty for cashing them in. And although there may have been, in 1945-46, a much greater danger of cashing them in, I think there was a greater danger than there possibly would be today, because there is a large amount of accrued interest on those bonds today. A seller of an E bond will take a very substantial penalty if he sold today. And the E bond yields 2.9, if it is sold today. If it were a 9-year bond, they would take a very severe penalty. If an 8-year bond, a little less, and so forth.

So that it seems to me there is less likelihood, in fact I would say none, of any substantial amount of those bonds being sold.

Senator TAFT. Isn't the long-term, 2½ percent rate sound enough today?

Mr. ECCLES. What is that, Senator?

Senator TAFT. The long term 2½ percent, long-term Governments, isn't that a fair—I mean, it wouldn't be greatly changed by removing the support price, would it?

Mr. ECCLES. I don't believe that it would. I, of course, don't know. My point is, so long as you announce a peg for that security you, in effect, make a 2½ percent demand liability out of a long-term bond.

As I said in my statement, it is equivalent to interest-bearing cash. And all other securities are related to Government securities. You cannot provide cheap money, at a rate that the Government wants, without furnishing it to the public at a related rate.

The difficult feature about the operation of a central bank is that when it stands ready to support a Government securities market at fixed rates, it automatically furnishes Federal Reserve funds to the commercial banks and enables them to expand bank credit by an unlimited amount. That is the difficulty.

The CHAIRMAN. Congressman Patman.

Mr. PATMAN. You state that you would let interest rates increase and seek their level?

Mr. ECCLES. Yes.

Mr. PATMAN. Don't you think there is some obligation of the Federal Reserve System to protect the public against excessive interest rates?

Mr. ECCLES. I think there is a greater obligation to the American public to protect them against the deterioration of the dollar. I think that is the obligation.

Mr. PATMAN. You mentioned the law of supply and demand. We have about three times as much money as we ever had before. Normally, under the law of supply and demand, as the amount of money increases the interest rate goes lower, does it not?

Mr. ECCLES. The interest rate is a controlled rate—

Mr. PATMAN. I see. Controlled by the Federal Reserve System?

Mr. ECCLES. Yes.

Mr. PATMAN. You deliberately controlled the interest rate, the last time, when the last issue of certificates and bills came out from the Treasury.

Mr. ECCLES. The Open Market Committee permitted the short-term rate on certificates to go up from 1½ to 1%, and later from 1½ to 1¾.

Mr. PATMAN. Which resulted in the failure of the Treasury to carry out its program of selling those securities at the rate fixed by the Treasury?

Mr. ECCLES. The Federal Reserve took care—

Mr. PATMAN. That was the result, was it not?

Mr. ECCLES. That is right. The Federal Reserve took care of that maturity. What happened was that the Treasury—

Mr. PATMAN. I know you took care of it, but the result was that the rate of interest was actually increased?

Mr. ECCLES. That is right.

Mr. PATMAN. Over what the Treasury fixed?

Mr. ECCLES. Yes.

Mr. PATMAN. Why does the Federal Reserve System permit that?

Mr. ECCLES. Well, why did the Treasury, we might ask, announce a rate that was contrary to the Federal Reserve's recommendation, and its willingness to support the market?

Mr. PATMAN. Who is master, the Federal Reserve or the Treasury? You know, the Treasury came here first.

Mr. ECCLES. In that instance the Federal Reserve prevailed.

Mr. PATMAN. And the Treasury, by law, is compelled to fix the rate on Government bonds, that is correct, isn't it?

Mr. ECCLES. Well, the Treasury has got to carry out its refunding, but you would expect that the Treasury would fix the rates in line with the market, instead of fixing the rate in line with an arbitrary pattern.

Mr. PATMAN. But the market was rigged by the Federal Reserve System. Here we have the ironical situation of our Treasury saying that the interest rate shall be low, we want the interest rate low, and then we have over here, across the street, an agency that has maneuvered itself out of the Government, away from the Government, using the Government credit absolutely free, sabotaging the Treasury's effort to keep the interest rate low.

Mr. ECCLES. How do you reconcile the Treasury's position of saying they want the interest rate low, with the Federal Reserve standing ready to peg the market, and at the same time expect to stop inflation? That is what we would like to know. I am saying that the Federal Reserve can prevail over the Government. I do not believe that.

Mr. PATMAN. I know, but the Federal Reserve did prevail the last time, because you had the power.

Mr. ECCLES. I would say that the Treasury deliberately prevailed. The Treasury knew what we were going to do, and it deliberately announced a rate that was contrary to the market rate that the Federal Reserve was supporting.

Mr. PATMAN. I think it is important that the Members of the Congress know this. The Secretary of the Treasury announced the other night over the radio, he made a public statement to the effect that he was going to retain the 2½ percent rate. Will the Federal Reserve System support the Secretary of the Treasury in that effort or will it refuse to support the Secretary of the Treasury?

Mr. ECCLES. I am not the Federal Reserve System.

Mr. PATMAN. I know, but you are an important official on the Board.

Mr. ECCLES. That is right.

Mr. PATMAN. You are on the Board of Governors.

Mr. ECCLES. Yes.

Mr. PATMAN. I suppose that you are about the oldest member of the Board, aren't you?

Mr. ECCLES. No, no; there is another as old as I am.

Mr. PATMAN. I am talking about in length of service; I am not talking about in age.

Mr. ECCLES. I am talking about both.

Mr. PATMAN. Who is older on the Board than you?

Mr. ECCLES. Szymczak.

Mr. PATMAN. He came there at the same time?

Mr. ECCLES. No; about a year before.

Mr. PATMAN. Well, you have been Chairman, you have had lots of experience, you are speaking for the Federal Reserve System now.

Mr. ECCLES. I am not speaking for the Federal Reserve System.

Mr. PATMAN. Yes, you are. We asked that the Chairman come and the Chairman couldn't come and they sent you.

Mr. ECCLES. No.

Senator TAFT. I requested that Mr. Eccles testify as an individual.

Mr. ECCLES. The Chairman did not send me up, and no member of the Board has seen this statement.

Mr. PATMAN. Individually—

Mr. ECCLES. This is my statement.

Mr. PATMAN. Individually are you going to support Mr. Snyder, or are you not going to support him?

Mr. ECCLES. Well, I don't think that that is a proper question.

Mr. PATMAN. It certainly is a proper question, because Congress has something to do with the Federal Reserve System; you are using the Government credit absolutely free of charge—

Mr. ECCLES. We are not using the Government's credit; we don't need the Government's credit.

Mr. PATMAN. You are sabotaging the Treasury. I think it ought to be stopped.

Mr. ECCLES. We don't need the Government's credit. The Federal Reserve isn't in position—

Mr. PATMAN. You say you don't need the Government's credit. What would you use for money? Every bill you issue represents Government credit. You can't issue a bill unless you have Government credit.

Mr. ECCLES. What I would like to know is this, What are the powers of the Open Market Committee?

Mr. PATMAN. That is what I want to find out too, because I think they have been using their powers to the detriment of the Government that they should serve.

Mr. ECCLES. We have been using our powers, to a limited extent, because of the raising of the short-term rate. So long as it is within the pattern of maintaining the 2½-percent long-term rate it is not in my opinion a very effective instrument because it does not have the effect of denying to the market Federal Reserve funds. Merely raising the rate that amount does not deny the market Federal Reserve funds, so long as you support the 2½-percent long-term rate.

Now, getting back to the relationship between the Federal Reserve and the Treasury, I am not one who would say that the Federal Reserve, or any central bank, is in a position to enforce its will, or should enforce its will, but it does seem to me that the Government, whether the Treasury or the Congress, or both, should recognize the facts of the situation, and the dilemma that a fixed pattern of rates creates for the central banking authorities, who have the responsibility, in the mind of the public, of preventing the creation of undue credit in the banking system, and who have the responsibility of preventing inflation, so far as they can, within the scope of monetary and credit authority.

Now, we cannot do that and carry out the mandates of the Secretary of the Treasury with reference to a freeze or a peg on Government securities. We should quit talking about the control of inflation while pursuing a policy that creates the very thing that we talk about controlling, and the public should understand that this policy which we are required to pursue is in itself an engine of inflation.

Now, I could have little sympathy with that policy.

The CHAIRMAN. May I ask you a question at that point?

Mr. ECCLES. Yes.

The CHAIRMAN. Bearing in mind that this committee has the function by statute of making recommendations to Congress, if we were to follow the line which you have presented here this morning, and recommend that Government securities should be priced in the open market, and that there should be no Government limitation upon the operation of the open market, and no Government support of Government securities, we would also be recommending that there should be a ceiling upon wages and very little price control. Now, would we then be putting ourselves in the position of saying to the Congress that the fiscal fraternity should be permitted to drive the price of Government bonds down and the interest rate up, while the Government would impose a ceiling upon wages?

Senator TAFT. Of course, a subcommittee of this committee has recommended Mr. Eccles' policy. You remember the report Mr. Patman signed by mistake?

Mr. ECCLES. Mr. Chairman—

Mr. PATMAN. That is a sore spot with me. I didn't sign any report by mistake. I didn't sign the report by mistake.

The CHAIRMAN. Let me say in defense—

Mr. PATMAN. I will challenge the Senator to show any report that I signed by mistake.

The CHAIRMAN. I think it is only proper to say—

Mr. PATMAN. I am very sincere about that, Senator Taft.

Senator TAFT. I was only kidding, Mr. Congressman. I was only kidding. I remembered—

Mr. PATMAN. I am glad that you make it plain. I understand that my name was signed to a report but I didn't sign it.

Senator TAFT. You withdrew the signature.

Mr. PATMAN. I didn't withdraw it. I didn't sign it. You can't withdraw something you haven't done.

Senator TAFT. It was signed by you, with your name, by mistake.

Mr. PATMAN. It wasn't signed by me, or with my permission.

The CHAIRMAN. The report did contain notes of—

Mr. PATMAN. I saw the report and I thought the notes I made would contradict the—

The CHAIRMAN. They did.

Mr. PATMAN. Contradict the report, so that certainly I wouldn't be charged with being an author of it. Somehow or other my name got on it, but I didn't put it there.

Now, let me ask him a question—

The CHAIRMAN. Well, I wasn't quite—

Mr. ECCLES. I would like to clear the record in one or two particulars in this connection in answer to your statement.

There were very extensive hearings by Senator Douglas' subcommittee, which was a part of this committee, a year ago. As a result of a questionnaire, and as a result of hearings held before Mr. Douglas' subcommittee, a report was made by that committee, and it seems to me that that report of Mr. Douglas' answers your question more fully than I could possible answer it here.

The CHAIRMAN. It has no relation to ceilings on wages, none whatever. Moreover, that report was never approved by the full committee. Let the record stand as it is.

Mr. ECCLES. Well, that answers, it seems to me, the dilemma that is now to the front again. All I am saying is this, that either the Federal Reserve should be recognized as having some independent status, or it should be considered as simply an agency or a bureau of the Treasury, whose primary function is to carry out the job of Government financing at the will of the Treasury, and at the rates established by the Treasury, without regard to the inflationary impact that may have.

The CHAIRMAN. But you have just testified to us, Mr. Eccles, that in your opinion the inflationary pressures since Korea, the deficit spending, has been on the side of private institutions rather than upon the part of the Government.

Mr. ECCLES. It has been entirely on private—

The CHAIRMAN. That is right. You have pointed out that bank loans have increased by several billion dollars.

Mr. ECCLES. Eight billion something, since Korea.

Mr. PATMAN. Nine billion eight, wasn't it?

The CHAIRMAN. Whatever the figure was.

Mr. ECCLES. Eight billion since Korea.

The CHAIRMAN. Since these bank loans did so increase as you have testified is there any reason to believe that the interest rise on Government short-terms during 1950 and 1949 had any deterrent effect?

Mr. ECCLES. I don't think that allowing the interest rates on short-term securities to rise is particularly effective, so long as they are not permitted to rise to the point where you do not support the long-term Governments. This is what happened. As the interest rates on short-term Governments went up, the rates on the long-term Governments went up too, and the prices went down. The rates went up beyond what they were, not to $2\frac{1}{2}$. Then at a certain premium price the Federal Reserve was required to support the long-term market and purchase hundreds of millions of long-term Government bonds in support of the market.

Now, there is not too much gained by letting a short rate go up, as long as it must remain within the pattern of the $2\frac{1}{2}$ long-term rate. These long-term bonds are nonbank securities, the banks couldn't hold these long-term $2\frac{1}{2}$'s, it is the nonbank investor. It seems to me that the long-term rates must be permitted to go up in relation to market forces, and that prices must be permitted to go down until a loss develops on the heavy sellers, which in this instance have been the insurance companies and the savings banks. These institutional investors have been selling long-term Governments in the market, and the Federal has been the residual purchaser. They loaned that money out into the market, and our purchase of those Governments created reserves for the banking system, not through the bank sale of them, although the banks did sell others, but through sales by nonbanking investors, insurance companies, and savings banks. In our support of that market we put reserves into the banks which made easy money for the banks. We put deposits in the banks for the insurance companies, who have been loaning those deposits all over the lot, as have the savings bank.

Now, that is what happened as a result of the support of the long-term market when we raised the short-term rate. If you want to take away the use of the traditional method, if the Treasury wants to take away the use of the traditional method of central banking

operations, which is to deny the market access to Federal funds, then they should provide some substitute powers, whereby, as I have stated in this statement today, and as I have stated in the Fortune Magazine article, and as I have stated in the past, we should be provided with powers over reserves, the right to sterilize the effect of the increase in reserves through our purchase of Government securities.

Mr. PATMAN. Mr. Eccles, let me proceed, if you don't mind. Your views on that I think are pretty well known.

Mr. ECCLES. I am just saying that we are in a dilemma here. We can't use one power and we are not given another.

Mr. PATMAN. Now then, you keep talking about the obligation of the Federal Reserve to prevent inflation, and I certainly think that is one of its duties, I don't know of any written obligation in law, but certainly it is one of the duties of the Federal Reserve to prevent the country suffering from inflation, and also from deflation. I have known of lots of things they have done to prevent the possibility of inflation, but I can't call to mind anything that has had a tendency to stop the country from suffering deflation, possibly there were some things done.

Mr. ECCLES. I could tell you some.

Mr. PATMAN. I won't go into that now—well, go ahead and tell me, I would like to know.

Mr. ECCLES. All right. The Federal Reserve has pursued an open-market policy to reduce rates. When you have a deflationary situation and unemployment, I think that everything should be done to create a favorable credit situation.

Mr. PATMAN. I do too. I don't happen to remember one certain act.

Mr. ECCLES. We have reduced reserve requirements.

Mr. PATMAN. I know, but you doubled them first.

Mr. ECCLES. However, increasing the reserve requirements only sterilized some of the redundant gold, and still left large excess reserves. Interest was almost at the zero point.

Mr. PATMAN. I don't want to interrogate you on that point—

Mr. ECCLES. You have done that before.

Mr. PATMAN. I will do it another time.

Now, Mr. Chairman, I want to make a request, that you call on the Federal Reserve Board to officially give us a reply as to what action they are going to take concerning the Treasury's policy—

Mr. ECCLES. It is the Open Market Committee. It isn't the Board.

Mr. PATMAN. Both of them, the Board and—

Mr. ECCLES. The Board is a part of the Committee.

Mr. PATMAN. It constitutes 7 members out of 12.

Mr. ECCLES. That is right. The Open Market Committee is the official body—

Mr. PATMAN. The Federal Reserve Board and the Open Market Committee, which is constituted by Federal Reserve Board members, seven members and five presidents of Federal Reserve banks—that is correct, isn't it, five presidents of the Federal Reserve banks?

Mr. ECCLES. That is right.

Mr. PATMAN. Call on them to give this committee an official reply as to what the attitude of the Open Market Committee will be,

are they going to support the Treasury or not going to support the Treasury?

In other words, are they going to support it or will they sabotage like they did before? I think they sabotaged.

Mr. ECCLES. I can't accept that. I don't think they sabotaged at all.

Mr. WOLCOTT. I suggest that we again have Mr. McCabe and Mr. Snyder back up here in executive session and try to get them together again on that.

The CHAIRMAN. I think that it is important for this committee to get all of these facts.

Mr. PATMAN. I am insisting on that, Mr. Chairman, that you call on him to tell the Federal Reserve Board and the Open Market Committee that we want that information.

The CHAIRMAN. We will go into it as far as we can, and have the Secretary of the Treasury, and others, here; probably, however, in executive session.

Mr. PATMAN. I want you to know, Mr. Chairman, that I am going to insist on it. I think it is in the public interest that we know the attitude of the Open Market Committee on Treasury policy. Mr. Eccles mentioned about being tied down by certain laws, rules, and so forth.

I think the Federal Reserve System is about as far removed from the control of the Government, or any agency thereof, as any agency could possibly be.

The CHAIRMAN. Your position, Mr. Patman, is, I take it, that under the Constitution the Congress has very complete power over the monetary system?

Mr. PATMAN. That is right.

Mr. ECCLES. I agree with that.

The CHAIRMAN. The Federal Reserve System is a private institution—

Mr. PATMAN. A creature of Congress.

Mr. ECCLES. It isn't private. It is public. Not private.

The CHAIRMAN. It is not a Government institution first, *per se*.

Mr. ECCLES. Yes; it is a Government institution, it is created by the Government, it reports to the Congress.

Mr. PATMAN. It is foot-loose and fancy-free.

Mr. ECCLES. Its earnings are returned to the Government. It is not a private profit institution or system at all. It is strictly a Government body, operated in the public interest. It is a creature of Congress.

Mr. PATMAN. That is what I wondered about, being operated in the public interest, that is what I want to find out.

Here are certain things which I think are not in the public interest. First, the members of the Board have a 14-year appointment, they are not responsible to the President of the United States, the Executive, they are entirely divorced from the Executive.

Mr. ECCLES. Congress should change the law.

Mr. PATMAN. The only control that Congress has is to go through the parliamentary procedures and get a law passed.

Mr. ECCLES. That is right.

Mr. PATMAN. Which is very little control over any agency. Of all of the agencies, I think, entitled to criticism for the loose way in which they are run and operated, a kind of model for all other agencies is the Federal Reserve.

Mr. ECCLES. I would have to defend that.

Mr. PATMAN. They get their profits entirely through the use of Government credit.

Mr. ECCLES. The profits go back to the Government.

Mr. PATMAN. I know, I will get to that myself. The profits go back to the Government. They used to. Under the law they did; 90 percent had to go back to the Government. The Federal Reserve, or somebody, brought about that repeal.

Mr. ECCLES. It is not in there now. The Government—

Mr. PATMAN. Wait a minute. That was repealed.

So they are loose from the Government; 14 years' appointment; the Secretary of the Treasury is off of the Board, he used to be on the Board, and he is now off; the Comptroller of the Currency is off the Board.

They are entirely divorced from the Government.

Now, when you make the profits which the Federal Reserve makes—and I am not criticizing the amount you do so after having paid out expenses for any purpose you want to pay them out. I am not sure whether some of those purposes are exactly proper or not, but I am not bringing up that question at this time.

After they pay out all of the expenses they want to, they voluntarily have been, in the last year or two, putting over 90 percent back into the Treasury. That is a voluntary act. They don't have to do it. They are under no law which compels them to do it. But they know that their own hides are involved in this deal, using the language of the street, and they want to cultivate the good will of the Congress by voluntarily paying that money over. But they can stop at any time, and they can pay out any amount for expenses that they want to, before they do that.

I think that is a loose way of running any agency of Government.

Mr. ECCLES. Of course, those are not the facts. That isn't the record.

Mr. PATMAN. Tell me which one is not a fact?

Mr. ECCLES. All right.

Mr. PATMAN. First, is there a 14-year appointment not responsible to the executive department? Is that true?

Mr. ECCLES. That is right.

Mr. PATMAN. No. 2, the Secretary of the Treasury, the Comptroller of the Currency, were on the Board. They have gotten off?

Mr. ECCLES. Yes.

Mr. PATMAN. No. 3, seven members of the Board, five members being presidents of Federal Reserve banks, constitute the Open Market Committee, using the credit of the Government any way they want to use it. It is up to them to use it, within the limitations and restrictions of law only?

Mr. ECCLES. That is right.

Mr. PATMAN. Now, what part of it is not true?

Mr. ECCLES. That isn't all you said.

Mr. PATMAN. I said you voluntarily turn over the 90 percent; there is no law compelling you to?

Mr. ECCLES. Let me—

Mr. PATMAN. Is that true, they turn over the 90 percent, by agreement with the Secretary of the Treasury?

Mr. ECCLES. I appeared before the committee of the Senate while I was Chairman, and it was the view of the committee that it should

be done on a voluntary basis. When I came up and suggested that there was a way we could do it, on this basis, if Congress didn't want to pass a law, they required it. It was the will of Congress, after it was presented to the Banking and Currency Committees of the House and Senate, that we do just what we are doing.

Mr. PATMAN. Why don't you ask for a law on it?

Mr. ECCLES. I came before the committee, and the committee said if a law isn't necessary, why—

Mr. PATMAN. I never heard that before in my life.

Mr. ECCLES. They said, "We have got too many laws to consider now."

Mr. PATMAN. I never heard of that before in my life.

Mr. ECCLES. That is a fact.

Mr. PATMAN. When did it happen? I am not questioning it.

Mr. ECCLES. I think 3 or 4 years ago.

Mr. PATMAN. It could happen when I wasn't there. I am not questioning it.

Mr. ECCLES. Three or four years ago.

Mr. PATMAN. That is no way to do business. If you want to turn back so much, you ought to have a law requiring it, like you used to have.

Mr. ECCLES. We can't pass laws; it is up to the Congress. They didn't choose to pass a law. It was the Congress that repealed the law that was in existence. We are an agency of the Government. We are appointed by the President, and the Congress has the right to confirm or veto that appointment. We report to the Congress under provision of law. We keep a public record. We keep a record of policy. We must make a public record. The Federal Reserve Board is given general and direct supervision over the Federal Reserve banks. We were not put under the Budget. We were not put under civil service. And that was after expensive hearings by the Congress. They determined that the Board, as the agent of Congress, should be the one to supervise these 12 Federal Reserve banks, and their branches and be subject to an accounting to and a report to the Congress.

Now, that is exactly the position that the Reserve System is in, and I, for one, would like to see the Congress investigate the conduct of the Federal Reserve System, and whether or not it is run loosely and extravagantly, as you seem to imply, because that just isn't true.

Mr. PATMAN. Don't you think the General Accounting Office should go over the books and papers, like all other agencies of Government?

Mr. ECCLES. I don't think so; no. I think that if you are going to make the Federal Reserve a Government agency, which Congress chose not to do, then let it be like any other Government agency.

The CHAIRMAN. The issue here is not so much whether that law should be changed. That, of course, is an open question. The issue here—

Mr. ECCLES. It is a question—

The CHAIRMAN (continuing). Is whether or not the Federal Reserve System has more authority than it ought to have to counteract the decisions of the Treasury.

Mr. PATMAN. And whether—

Mr. ECCLES. It has no authority to counteract them, except through refusing to carry out the wishes of the Treasury—

Mr. PATMAN. Whether or not it is abusing the power and authority that it has now.

The CHAIRMAN. Let me ask another question here, Mr. Eccles.

In all of this discussion about interest rates, we have not as yet discussed the effect of increased interest rates upon Government securities, upon the annual obligation of the Government to raise by taxation the money necessary to pay that interest.

The total amount of interest payments by the Government on Government securities has been steadily increasing. In 1951 it was \$5,722,000,000; for 1952, the budget estimate is \$5,897,000,000.

In other words, it is gradually creeping up to \$6,000,000,000.

In 1939, before we became involved even in the preparation for World War II, the total budget for the Federal Government for all purposes—military, foreign, veterans, and domestic, and all the rest—was only about ten and a quarter billion dollars. So that we are now paying interest upon the national debt a sum that is considerably more than half of the total cost of the Federal Government in 1939. ¶ I would like to have your opinion as to whether or not the increase in rates upon Government securities that would result from the type of open-market selling that you advocate would be such as to increase the annual Government obligation upon the debt?

Mr. ECCLES. I am not advocating open-market selling, but I am advocating a restriction in open-market buying of Government securities at pegged prices at the will of the market in an inflationary period when you want to reduce the expansion of bank credit as an anti-inflationary measure.

The CHAIRMAN. Do I understand you are against pegged prices?

Mr. ECCLES. That is right.

The CHAIRMAN. Therefore, you want the prices of Government securities to seek their own level in the open market?

Mr. ECCLES. That is right.

The CHAIRMAN. That is not the rule that you advocate with respect to wages; it is not the rule that you advocate with respect to credit controls; it is not the rule that you advocate with respect to any other of these items which have been suggested to control inflation, except price control.

So, my question to you is whether if we permit the interest rates upon Government securities to rise, as they have formerly risen when we did not have the support program, the effect would be disadvantageous upon the annual burdens of the Government to meet?

Mr. ECCLES. I do not believe that that is necessarily true, and I do not believe that supporting the interest-rate structure is helpful to labor and to the public generally, because by the support of the interest-rate structure you are creating a basis for inflation which is—

The CHAIRMAN. I understand—

Mr. ECCLES (continuing). Which is far more costly.

The CHAIRMAN. That is another phase of the question.

Mr. ECCLES. No. Which is far more costly to the Government than an increase in the interest rate would be.

The Government, with a budget of \$70,000,000,000, is certainly influenced by costs, and that budget can be double that if you continue to expand the supply of money by a policy of excessively easy money.

Now, that really is the problem, and so what it costs the Government in interest rates may well be a small factor of what it will cost the Government in connection with all of its military and other expenditures.

The CHAIRMAN. The cure necessarily would be to sterilize a larger proportion of the money supply and that you have recommended.

Mr. ECCLES. That is one alternative, but we don't have the freedom to follow it. And I suggested in the program that we should be provided with an alternative method, but we are not.

The CHAIRMAN. And—

Mr. ECCLES. Could I finish on that point?

The CHAIRMAN. Yes.

Mr. ECCLES. The increased cost of inflation to the Government would inevitably result in increased payments to all groups except investors. But why should the investor be the forgotten man? We do not hesitate to increase the wages of labor if the costs of living go up. We do not hesitate to pay for defense what the suppliers want or require for their material. We do not hesitate to furnish parity prices for farmers. Why should the people who have relied upon their insurance and upon their savings and upon their pensions and upon their annuities be the ones that should be expected, as the purchasing power of the dollar goes down, to get no consideration whatsoever with reference to interest rates?

Now, this increase in interest rates is not a device to help the banks, and I am not proposing it for the purpose of helping the banks, or business, or industry, in any sense of the word. If the banks make excess profits, they are going to pay for them. If the increased interest rate accrues to the benefit of the banking system, the Government will recover a substantial part through excess profit taxation.

The increased interest rate would primarily benefit the people who own insurance, the people who have money in mutual savings banks and building-and-loan companies. It would accrue to the benefit of pension and endowment funds, educational institutions, religious organizations, and the people individually who have bought Government bonds, considering them the best investments in the world and expecting, when those bonds mature, that they would get a dollar of stable purchasing power. Today these groups that I have enumerated seem to me to be the forgotten men.

I cannot see why, in discussing this matter of the interest rate, we should be loath to give them some consideration. We should not ignore them in order to save the Government a few hundred million or a billion dollars, when we pour out the billions we do for every other pressure group, and for our defense and foreign-aid program, which I am certainly for.

The CHAIRMAN. If we abandon support of Federal securities in the open market, and allow interest rates to increase, isn't it inevitable that the price of those securities would fall?

Mr. ECCLES. I am not sure that they would fall. They may temporarily go down, but I do not think they would fall far.

The CHAIRMAN. If they do go down, it means a capital loss for the holders of those bonds which go down.

Mr. ECCLES. But those holders would not sell to be making other loans. That is my point. My point is that they would hesitate to sell where they get too low. Today, when they can sell at a premium, there is an inducement. As long as you peg the short rate at $1\frac{1}{2}$, the longer-term securities, as they approach maturity, not only yield $2\frac{1}{2}$ percent currently but a substantial premium, which is created as a result of a lower peg on short-term securities.

The CHAIRMAN. The head of a very large insurance company has made the recommendation that the Government ought to issue long-term securities for a term of at least 35 years at an interest rate of 3 percent to be sold to insurance companies and savings institutions and not to commercial banks. Have you any opinion to express upon that?

Mr. ECCLES. I would not issue long-term market securities so long as there is an announced pegged price on long-term Government securities, because that is only creating a demand liability out of long-term securities.

Now, if there is to be freedom in the open-market operation, so that there is some hazard in buying the higher yielding security, then I would not object to issuing a $2\frac{1}{2}$ percent or a 3 percent, or whatever rate the market required, to sell a long-term market security. So long as we are going to peg the $2\frac{1}{2}$ -percent rate I would issue only nonmarketable long-term securities, so that the holder of those securities would get the rate based upon the period which he held it, which would be the pegged pattern of rates that the Federal Reserve is required to maintain, $1\frac{1}{2}$ to $2\frac{1}{2}$.

It makes no sense to issue long-term marketable securities with any such a peg and pattern, because all it does is to pay too much for demand money.

Mr. PATMAN. You mean the banks pay too much for demand money?

Mr. ECCLES. Long-term securities are not held by the banks, they are only eligible to nonbanking investors—

The CHAIRMAN. It may be appropriate to announce that on Thursday, February 1, at a meeting of this committee, in room 318, Senate Office Building, the program calls for a round-table discussion of monetary credit and debt-management problems. Those who will participate in that include the following: Mr. Howard Bowen, of the University of Illinois; Albert S. Hart, of Columbia University; Wesley Lindow, of the Irving Trust Co., New York; Lawrence Seltzer, of Wayne University; Walter Spahr, of New York University; and Paul W. McCracken, of the University of Michigan.

Mr. ECCLES. Mr. Chairman, I have a statement which I would like to see put in the record, and I have brought some copies which I would like to make available to the committee. It is a statement that came across my desk the day before yesterday. It is an economist's statement on antiinflationary measures. It is only three and a half pages. It is the finest brief statement I have seen.

The CHAIRMAN. The committee will be very glad to receive the copies. We will distribute them to all members.

Mr. ECCLES. It is signed by 400 of the outstanding economists in this country. I think it is a statement that should be given wide publicity.

The CHAIRMAN. The committee has already received the statement and it is being included in a monograph prepared by the staff on the monetary problems.

(The statement referred to will be found on page 54 of the joint committee print entitled "General Credit Control, Debt Management, and Economic Mobilization.")

We are very much indebted to you, Mr. Eccles. As usual you have given us a very stimulating session. We thank you for your presentation.

Mr. ECCLES. Thank you, Mr. Chairman and members of the committee.

The CHAIRMAN. The next meeting of the committee will be in this room tomorrow afternoon at 2 o'clock when Mr. Eric Johnston and Mr. C. E. Wilson will appear.

(Whereupon, at 1:25 p. m., the hearing was recessed to reconvene on Friday, January 26, 1951, at 2 p. m.)

JANUARY 1951 ECONOMIC REPORT OF THE PRESIDENT

FRIDAY, JANUARY 26, 1951

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The joint committee met, pursuant to adjournment, at 2 p. m., in room 362, Old House Office Building, Senator Joseph C. O'Mahoney (chairman) presiding.

Present: Senators O'Mahoney and Flanders; Representatives Hart, Patman, and Buchanan.

Also present: Theodore J. Kreps, staff director, Grover W. Ensley, associate staff director; Fred E. Berquist, minority economist; and John W. Lehman, clerk.

The CHAIRMAN. The committee will come to order.

Since we are meeting in room 362 of the House Office Building I think it is appropriate to announce that our first witness this afternoon will be a Member of the Senate, who has agreed to submit himself to the 5-minute rule of the House, Senator Flanders, former president of the Federal Reserve Bank of Boston, former chairman of the Research and Development Committee of the CED, who desires to talk to us for about 5 minutes on economic flood control.

Senator Flanders, the blackboard is yours.

Senator FLANDERS. Mr. Chairman, I am very grateful for the privilege of appearing before you and will abide by that 5-minute rule. Should I run over a moment or two I will be glad to have my malfeasance indicated in any way that seems to be appropriate.

Now, I am going to draw a little diagram on this blackboard.

The CHAIRMAN. Should I have said you were a former Vermont school teacher too?

Senator FLANDERS. I am going to draw a straight line here. That line represents the American way of living. On it we will put a little house here, a chimney on it, and a television antenna. Here we will put an automobile; here is a schoolhouse, maybe it is a small college. Here is a barn, some cows outside. That is a cow.

That is American life as it is lived when everything is normal.

Now, here is the flowing stream of prices, like that, and it begins to be noted that that stream is rising. The American standard of life has got to be protected. So what will we do? We will build a dike. Here it is. That is the dike. We will build that dike.

The price stream rises and rises and rises and we build the dike a little higher and the stream rises and rises and we keep the dike ahead of the stream all the time.

But there are two things to consider. That is good for an emergency. The Mississippi is up for a few weeks at a time and goes down. In the Second World War we were quite sure we were passing

through a crisis which was going to end. Now we are told that the situation we are facing is 2, 3, 5, 10, 15, 20 years; who knows?

Twenty years behind the dike with rising water. Now, that dike is necessary. All I wish to suggest is this, that something had better be done, somebody had better see what can be done with flood control at the headwaters of the stream, because you cannot keep that dike tight for 10 years. That is all there is to it. And someone has got to see about the headwaters, control of the height of that stream, or it is going to break through and flood the American way of living.

That is all my talk is for. It is all that it is about. I sincerely hope that besides working on the building of the dike and raising it higher and keeping it tight, that we are going to do a little floodwater control at the headwaters of the flood.

That, Mr. Chairman, is the purpose, the purport, and the end of my 5-minute discussion.

I might say, however, that this board has ample height and the same diagram can be carried to any degree of inflation which may appear in the future. For the present that is all the higher we will carry it.

The CHAIRMAN. I take it that your point, Senator, is that if you build the dike too high, without reducing the flow of the stream, the dike may topple over upon the American way of life and do as much damage as the water?

Senator FLANDERS. Sir, you have learned my lesson perfectly. Thank you.

The CHAIRMAN. The time of the Senator from Vermont has expired.

**STATEMENT OF ERIC A. JOHNSTON, ADMINISTRATOR,
ECONOMIC STABILIZATION AGENCY**

The CHAIRMAN. Mr. Johnston, everybody, I think, will agree that the illustration given by the Senator from Vermont is a very accurate one, and illustrates more effectively than a lot of words could the importance of complete public understanding of the cause and cures of inflation—probably I should put both words in the plural—the causes and cures, for it would be very difficult to select one or two specific causes, and I don't know whether, as Administrator of Economic Stabilization, you have yet come to the conclusion that there is one particular cure.

However, it must be perfectly clear to all that public participation in whatever public policy may be undertaken is one of the essentials of the fight against inflation. This committee, because of its responsibility under the law to review the President's reports, is now endeavoring to get as wide an expression of opinion from competent authority as can possibly be obtained.

We realize that you have only recently been confirmed as Administrator of the Office of Economic Stabilization. In fact, it was the day before yesterday, I believe. We have, however, from previous experience, very accurate knowledge of your ability as an advocate and as an analyzer of economic affairs.

The floor is yours, sir, if you care to make an opening statement. I should say to you—this is off the record.
(There was discussion off the record.)