BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Statement for the Press

For immediate release February 17, 1943

Statement of M. S. Eccles, Chairman of the Board of Governors of the Federal Reserve System, before the Banking and Currency Committee of the Senate on S.700, a bill to amend sections 12B and 19 of the Federal Reserve Act.

Mr. Chairman and members of the Committee:

This measure provides that for the duration of the war and six months thereafter so-called War Loan Deposit Accounts shall be relieved from Federal deposit insurance assessments and from reserve requirements. Its enactment will help to perfect the machinery for and thus facilitate and make smoother the Government's war-financing operations.

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

As members of the Senate Committee will recall, war loan accounts were originally authorized by the Liberty Loan Acts in the last war and are now authorized by the Second Liberty Loan Act as amended. This Act provides that the Secretary of the Treasury may deposit "in such incorporated banks and trust companies as he may designate, the proceeds or any part thereof, arising from the sale of the bonds and certificates of indebtedness, Treasury bills and war savings certificates authorized by this Act . . ."

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

When banks which have qualified for war loan accounts subscribe to Government securities for their customers or themselves, they enter the amount of their allotted subscriptions in the war loan accounts on the payment dates and subject to call by the Treasury. Subsequently, as the Treasury has need for funds, a call is issued; that is, notice is given to these banks to transfer to their respective Federal Reserve Banks whatever percentage of the funds in the war loan accounts is required by the Treasury to meet its current expenditures. Thus the war loan accounts are drawn down gradually as Treasury needs arise, the money is checked out of the Reserve Banks by the Treasury and ultimately flows back again to the banking system as deposits.

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

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

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

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

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