

BANKING'S PART IN THE NATIONAL FINANCIAL STRUCTURE

Address

By

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I find it impossible to fence in the topic assigned to me and then work it neatly and independently like a good farmer in a forty-acre field. The subject covers too much ground. Ours is a money economy and banking enters into every single phase of it. The ramifications are world-wide. Daily in recent years plans have been forming in some dictator brain thousands of miles away that have shaped the future of banking and determined the nature of its problems far more than events at home have done.

A speaker today is caught between the rock and the hard place. If he speaks out positively, events of a year or two, perhaps even a month or two, may contradict everything he says; yet if he doesn't speak with conviction, the audience may walk out on him. There is nothing for him to do but to state his opinions as if they were facts, and hope that time will be good to him.

Banks stand at the crossroads of our economic system. This is because they supply the bulk of the money which we use. About 90 per cent of all money transactions are made by the use of checks drawn upon deposit accounts at commercial banks. Thus the banking system can never be considered as an entity apart from our whole economic life. Its place and functions must always be related to the dominant forces which are determining the economic life of the nation.

Right now our economic life is centered on the all-embracing objective of winning the war. It dominates the minutest detail of our whole national life. Literally, nothing else counts or can be permitted to count but to organize all our power toward winning the war as speedily and as decisively as possible. This must be just as true of the men who operate the service stations of our money system as it is of automobile manufacturers. It simply has to be understood by all of us whether we work in an office or a factory or on a farm.

We have talked a lot about all-out mobilization for war but we haven't understood the words. Generally, we are unconscious victims of a belief in our own invincibility; a conviction that we can lick the world with one hand tied behind us. We have been slow to realize that one loaded machine gun has far greater power in an immediate test of strength than a whole range of mountains filled with iron and copper ore. All of us in some degree have been going along in the belief that, while some sacrifices are necessary, it is the other fellow who will make them. I am afraid, furthermore, that too many of us are trying in every way we can to see that it is the other fellow on whom the sacrifices fall. We want to win the war comfortably with our future secure and our old privileges and immunities untouched.

It cannot be done that way. This is a desperate life-or-death war in which the outcome is by no means certain. The sooner we realize that there is a chance for us to lose it, the sooner we will be able to do the things necessary to win it. It will be a hard war that will last a long time. The length of the military struggle will be in the inverse ratio to the speed and thoroughness with which we devote our whole national energy to producing for and prosecuting the war.

The rules of war have changed -- many of us don't realize how much they have changed. A nation which has all the gold in the world can be beaten by a nation that hasn't a pound of it. The United Nations are facing that lesson through bitter experience.

Victory in modern war depends upon having men with courage, devotion, and skill who are equipped with the best machines. Behind the lines there must be a production organization that is geared to turn out in overwhelming amount the most

efficient planes, tanks, guns, ammunition, and ships, and to keep them flowing to the fighting forces along with food and other essentials for the armed forces and for the workers on the home front. It is fighting men and finished goods of war that count, not the number of untrained men, the amount of raw materials still buried in the ground, or the number of factories still equipped only to turn out the goods of peace.

The United States, with its Allies, can put in what it takes to win this war with less concern over its financing than can the opposing nations. We can do it with less concern over the financial consequences than any other nation. We know confidently that on the day when guns fall silent and we stand victorious, when in spite of what we have put into the war, we will emerge with our soil and our raw materials unimpaired, with the greatest producing plant and with the greatest army of trained and skilled workers in the world's history. Those, under the genius of management which this nation will not lack, are the elements of real wealth. We shall not have expended them.

I do not say that the task of financing this war does not present many and difficult problems. I merely say that we can do it without present or future disaster, no matter what size the job ultimately may assume. We will do it well, however, only under conditions that hold prices under control and enable no man to retain inordinate profits gained because of the vast expenditures this effort will entail.

The challenge that confronts our financial agencies and our banking system is to chart a course of financing that will least distort our economic system and our financial structure. I wish to emphasize that we are undertaking the greatest task that ever confronted this nation. It involves a job of financing that some of us, even a few months ago, might have said was impossible. To accomplish it

successfully may require us to adopt self-discipline and controls that are new and to accept some concepts and patterns that have not been followed in wars of the past.

I am sure that bankers generally understand this. They realize, I believe, that every possible device will be used as it becomes necessary to insure financing the war effort. This fundamental understanding on the part of the financial community helps to explain its admirable calmness when it received the onslaught of war and the news of a national budget exceeding the wildest predictions of any of us up to as late as six months ago.

In order to place the financial outlook, as presented by the budget, in its proper perspective let me go back to May, 1940 when Nazi bombs started raining down on the Low Countries. At that time the total amount of money authorized for new armament in the United States was only about $\$2\frac{1}{2}$ billions. That sum will soon have been multiplied by more than 50 times and the expenditures are to be converted into production at the swiftest possible rate. By last September our total arms program, including funds for lend-lease, totaled about $\$60$ billions. We have all felt and seen the effects in the nation's economy and on the price structure even though up to the end of 1941 less than $\$15$ billions of that sum had actually been spent.

The President's budget message called for armament expenditures of more than $\$70$ billions during the next eighteen months. Even after the hoped-for allowance of $\$7$ billions of new taxes, the budget message estimated that the deficit for this period would be in the neighborhood of $\$45$ billions. Part of this, of course, would be met by receipts from the Social Security and other Government trust funds, but the remainder which will have to be obtained from

securities sold to the general public is still enormous. These expenditures and the estimated deficit cover only the next eighteen months. And I repeat my earlier prediction that the war will be a long one.

In considering the effects of such a program on our economy, and particularly on the banks, no speaker can be cocksure or dogmatic. He must be prepared to accept good-naturedly if tomorrow's events make a liar out of him. I believe his best approach, however, is to set forth his views boldly, and in the hope that those who differ with him will do so in tolerance and good humor. It is in that spirit that I advance some thoughts on a financing program which seems to me appropriate for the job ahead, and on the part the banks will take in it.

The first job is to raise the money, as it is needed. We know we are going to do it. After that, one of the principal objectives must be to offset the development of inflationary forces which are inherent in a situation of tremendous Government expenditures on the one hand, and curtailment of civilian goods on the other.

The first essential of a proper financing program must be deep-cutting and courageous taxation that currently will finance as much of the war program as possible. In general the taxation program should be designed to strengthen and expand the progressive elements of our tax system. This means higher rates for individual income taxes and fewer loopholes in the present system. It means heavier corporation taxes with particular emphasis on excess profit taxes. The accumulation of unreasonable profits in a period of war financing and production could be a principal factor in undermining national unity. We should try to eliminate them.

Before we get far along this war road, we may see a system of national

sales taxes adopted. If sales taxes come, I hope they will be graduated so as to bear down hardest on luxury goods, and will be collected from the last buyer in order to avoid pyramiding, and to make the taxes easier to get rid of when need for them has passed

Next, the funds which cannot be obtained from taxation should be borrowed to the fullest extent possible from the current savings of individuals and of business firms rather than from banks. That is desirable because bank borrowings create new money, while other borrowings use existing or future savings. The Treasury in its savings bond program has already issued securities designed to draw out the savings of individuals. Treasury tax notes provide a means through which the tax reserves of business are made available to finance the defense program prior to the date on which taxes are due. Other types of business funds, however, might be channeled into defense financing provided suitable securities were available. In the period ahead, it appears likely that non-defense capital expenditures by business as well as inventories and receivables will be reduced considerably; it might be well for the Treasury to consider issuing a non-market risk security which would tap these reserves and other funds which would normally be held by business rather than distributed to stockholders. Consideration might also be given to special long-term issues which would best fit the investment needs for insurance companies, mutual savings banks and other types of institutional investors which hold current savings of individuals.

Finally, and in addition to the funds raised by taxation and from current individual and business savings, a substantial amount of necessary financing will have to be raised in the open market, primarily from the banks. This type of financing should aim to supply the securities best adapted and most attractive to the purchasers. Since commercial banks will be the principal buyers, these securi-

ties should be shorter in term than those intended for insurance companies and savings banks in order to moderate the risk of market fluctuation.

A most important question in connection with Government financing is that of rates. This is certainly a subject upon which no one can be dogmatic. In my opinion all major considerations with regard to interest rates tend to insure that the Treasury and the Federal Reserve with the cooperation of banks, bankers and other financial institutions, will establish and maintain a pattern of rates within which the war financing will be done.

It seems to me that recent history and present conditions have already determined the general range of rates that will be established. Rates have been placed on savings bonds and on recent open market issues which cannot be departed from too far in succeeding financings. The reasons for this are fairly obvious. A rising tendency in rates involves the possibility of investors holding off with the idea of obtaining more favorable terms in the future. It might also lead to cashing by the public of a substantial amount of the present outstanding savings bonds. Moreover, it should be remembered that banks and financial institutions have more or less of a vested interest in the maintenance of low rates.

At the present time bank portfolios contain some 20 billions of Government securities. If rates on new long-term issues should increase very much these outstanding issues would drop sharply in price with unwelcome consequences on present bank holdings. Finally, in view of the controls which have been placed on many phases of our economic life, it is hardly likely that fluctuations in the cost of money to the Government will be left entirely to the vagaries of the market.

I hope these remarks will not be interpreted to mean that there can be no change at all in the interest rates. In recent months we have seen a considerable firming of short term rates. In view of the extremely low level of short term interest rates which resulted from the tremendous level of excess reserves and the liquidity preferences on the part of many important investors, an unusually wide differential has existed between short term and long term rates. Short term rates could show a further rise, it seems to me, without necessarily producing any increase at all in the general level of long term interest rates.

In view of the dependence upon banks to finance an important part of the war program, it will be necessary to assure that bank reserves are always adequate for this purpose. The Board of Governors of the Federal Reserve System announced at the outbreak of war that the maintenance of adequate reserves would be one of the keystones of Federal Reserve policy during the war. This does not mean that banks will necessarily have as high a volume of excess reserves as they were accustomed to have in the recent past. The war effort in England has been financed without any excess reserves at all. In view of the different character of the American banking system, involving some 15,000 individual banks, the continued existence of some excess reserves would seem to be necessary here.

There are several ways in which Federal authorities can move to increase banking reserves. One, obviously, is to modify reserve requirements. Another is through Federal Reserve open market purchases. As Chairman Eccles observed the other day when meeting with a Congressional Committee, the resources of the Federal Reserve System for that purpose are practically unlimited. One way in which individual banks can increase reserves to meet temporary demands is by borrowing from Federal Reserve Banks. I have heard the heads of many large and important banks throughout the country express themselves favorably on that method in recent months.

One aspect of the outlook for bank reserves warrants especial discussion here today. I refer to the increase in currency in circulation which, as you know, tends to reduce dollar for dollar the volume of bank reserves. On February 4, the figure known as "Money in circulation" had reached a record high of slightly over \$11.2 billions, which was \$2.6 billions above the corresponding date a year ago. Excess reserves of all member banks on February 4 stood at slightly over \$3.3 billions, a decline of about \$3 billions from the previous year. Most of this decline in excess reserves was caused by the increase in money in circulation.

Many factors, no doubt, are responsible for this trend. A greater amount of coin and currency is used when business is active than when it is not - and a swiftly rising volume of transactions has accompanied the national war program. But after making allowance for that, a considerable amount of the withdrawals of currency have gone into hoarding. Should hoarding continue or increase, action would have to be taken, either by the Treasury or the Federal Reserve System, or both, to offset its effects.

I predict that this outward movement of currency will soon have run its course, and the return flow to the banks will set in. After all, the people of the United States are essentially reasonable. Money invested in Savings bonds, or money on deposit in financial institutions which in turn invest in Government bonds or in loans to keep the wheels of America turning, is working for its country; it is patriotic. Money that is withdrawn from use, hoarded in the dark, is not working for anyone, either its possessor or for his country. It is not patriotic money.

One of the reasons given for currency withdrawals is that a few people fear the Government is going to tax, or confiscate, or commandeer their savings or other assets for investment in defense bonds. There are no grounds whatever for these

fears. The Government not only has no intention of the sort and won't do it; any such step would directly contradict the policy which the Treasury is following, and must follow, in financing the war.

There would be no gain to the Government if existing savings on deposit with banks, which the banks in turn have invested in Government securities or loans, were forced into direct investment in defense bonds bought by individual depositors. Banks would be forced to sell on the one hand what the individuals bought on the other.

I can understand why an individual depositor might prefer to invest directly a part of his savings in defense bonds, but I can't for the life of me see how he thinks he is protecting himself or his future by withdrawing currency and locking it up. Defense bonds, like currency, are non-market-risk obligations of the Government. Defense bonds are redeemable, without loss to the holder. The main difference is that the bonds yield an interest return, and currency does not.

Another reason sometimes given for currency hoarding is that the hoarder believes he is concealing his assets when he holds currency in a safety deposit box or in a hole in the ground. This to my mind must be a hangover from the days when it was possible to hoard gold or gold certificates in anticipation of a rise in the value of gold in terms of currency, such as occurred during and after the Civil War. The idea that hoarding currency effectively conceals cash assets seems to me to be extremely far-fetched. I believe those who do it would see upon analysis that they are simply fooling themselves.

At the present time we have a paper currency which is convertible into gold only for certain designated purposes. This currency is uniquely identifiable - that is, no one bill is exactly like another. Each is distinguished by an issuing

agent and by a number. Such bills cannot be effectively concealed. If the Government decided that hoarding had reached an amount that was detrimental to the general public interest, it could call in all outstanding currency and announce a deadline after which currency of the outstanding series would no longer be redeemed. Anyone who failed to turn in his currency within such a time limit would have to show proof that he was not aware of the redemption order. The hoarder who did not wish to divulge his holdings of currency would, under such circumstances, be left with nothing but valueless pieces of paper.

I don't think that such drastic measures will become necessary. In fact, I believe that hoarding will cease when people realize the difficulties it might cause and, more important, understand what little protection the hoarder really has.

What the Treasury really wants is to have more and more defense bonds purchased out of current savings from current earnings and income. That makes sense. The object isn't only to get finances for the war; it is also to reduce the percentage of current income spent in the market for goods at a time when the supply of goods for civilian consumption is being sharply reduced by the conversion of factories and materials to war production.

No, the Government is not going to move in on the past savings of its citizens. I don't think any of us can be sure that it may not take steps to compel future savings to be made and to be invested in defense bonds. But there is a vast difference between the two propositions which I hope I have cleared up a little.

Bankers are, of course, concerned with every phase of the war. I have indicated some of the measures for avoiding inflation that are involved in the financing program. Any complete plan for inflation control must go beyond this. Inflation must be attacked on a broad front. It must include a system of direct

price controls and rationing in those fields in which supplies are especially short in relation to the demand that will be generated by rising defense expenditures. Already we have seen rationing instituted for articles made of rubber and for sugar. No doubt it will be extended to other lines in the relatively near future.

Attention must be directed toward preventing widespread increases in wages. In my opinion, there is only one workable approach to the problem of wage controls. Wage increases can be held within reasonable limits only if there is effective control of prices on the one hand, and of the war profits of industrial corporations on the other. If further general price advances are prevented, and if courageous and far-reaching taxation recaptures corporate profits that are due to war orders and war spending by the Government, a sound foundation will have been laid for a policy which outlaws general wage increases. Without both it is going to be difficult to institute any practicable system for fixing wages.

If the united strength of the banking community could be thrown back of the program I have suggested, it would be a powerful influence in restraining monetary inflation. To repeat, the elements are: (1) Taxation to pay as we go to the fullest extent we can; (2) Treasury issues kept continuously on sale and specifically planned to attract the investment of future savings of institutions and individuals, and the balances of business firms; and finally, after securing the absolute maximum of financing outside of commercial banks, to offer the banks short and intermediate term issues adapted to their needs.

The basic reason for using banks' financing to the smallest possible degree cannot be too often stated. Non-bank investments employ existing funds and future savings; they do not add to the supply of money. Borrowing from banks, on the

other hand, increases the money supply, and to that extent aggravates the task of those who are fighting to hold back inflation.

Thus far I have talked to you as bankers faced with the immediate job of doing your part in financing the war. While we are doing that, we had better be looking through and beyond this immediate task in order that, after winning the war, we may not lose the peace, either at home or abroad.

I have a great deal of sympathy for the man who looks back longingly upon America's pioneering days when we had physical frontiers to develop, and hopes for their return. There were many problems we didn't have to face and could postpone in those days when the jobless and the overcrowded could move out and take up free land and when the outside world was ready and eager to buy all the raw materials we could produce, providing us with capital in return. We have gone far from that condition in the past two decades, and we will be farther away still when this war ends.

The world that emerges will be totally unlike the world we have known. But the challenge of a frontier still confronts us if we will only see and rise to meet it - a challenge more stupendous, more breath-taking, than any that faced our forefathers.

There is only one assumption for us to make as we look forward to the end of the war - we are going to win it. We will emerge, as I have said repeatedly, with the finest mechanical plant and the greatest army of skilled producers we have ever had, and with our natural resources unimpaired. We will also have incurred an enormous national debt. Let us be realistic about it; the size of that debt will be an academic matter if we should lose this war. But it is only natural that men who have spent their lives in financial service should feel grave concern

as to its ultimate size.

On June 30, 1940 the national debt stood at slightly over \$40 billions. By June 30, 1943 it is estimated the debt will increase to over \$100 billions. Notwithstanding the Government's effort to cover the costs of war so far as possible with current revenues, the debt may go far beyond that amount before the war is over.

No one likes the prospect of a public debt of such magnitude, but this isn't a question of likes and dislikes. We are in this war, and the debt has become nearly an inevitable fact. The question, therefore, is what we are going to do about it.

Americans are not defeatists by nature. On the whole, we have been incurable optimists. This is no time to change. Let us then look at this problem of the public debt with confidence that it does not mean the end of America or of the American way of doing things.

On the positive side, we note these factors: The bonds will be held by citizens of this country. Service payments raised by taxes from one generation will be paid to the same generation. It will be an internal debt, so we avoid the impossible task of transfer which accompanies large external debt. We will end the war with a high tax structure, capable of yielding enormous revenues if national production and national income are maintained.

The challenge, the new frontier, therefore, is this question of learning how to use our resources and our man power in full production when the war ends. There isn't any dodging the issue. Democracy, here or abroad, must meet and solve

it in order to survive. If we meet it successfully, then we will be able to go forward whether the public debt is big or little. If we fail, it will not be the size of the national debt that defeats us; it will be because we haven't been able to provide continuous employment and full production.

The annual dollar cost of public debt service is less important than is the size of the national income. The annual charge on a public debt unit of 100 billion dollars would be about 2.4 billions at current average rates. That amounts to 2.4 per cent of an income of 100 billions. Added to the interest charge on private, municipal and state debt, which should all show some decline, the total interest charge, with the national debt at 100 billions and a national income of the same figure, would amount to around $7\frac{1}{2}$ per cent, all of it payable to ourselves. To place this in perspective, let me point out that the share of the national income required in 1929 to service public and private debt amounted to 11.5 per cent; in 1932, 20 per cent.

Perhaps I have dwelt too long on the relationship between public debt and national income. We would have the same gigantic task to face even if the public debt were insignificantly small as it was in 1930. It is a task we left unfinished, perhaps even uncharted, when we assumed vast new responsibilities in this world-wide war.

I believe that our greatest common mistake today is our failure to realize what is happening in the world. This isn't just a war in the sense of past wars. It is a world-wide revolution. It is a revolution, moreover, that feeds on the mistakes of democracies. Hitler has had strength back of him because of the economic failure of free, democratic governments to substitute plenty for scarcity through providing full employment for the man power and resources of the world.

We believe that democracies embodying the institutions of human freedom can guide that world revolution better than can dictatorships that deny freedom. But the challenge is breath-taking. In the long run future democratic leadership cannot meet it unless it performs better than it has done in the past. It cannot meet the challenge if it is content to rest on the efforts and the devices of the past which have produced the paradox of scarcity and want where the materials and the opportunity for abundance exist.

These are the responsibilities that confront the democracies today. The people of the United States must understand the implications of the world crisis and they must see clearly the consequences of our own behavior. Without that common, general understanding, leadership will be powerless to deal with the tremendous difficulties that are ahead.

In conclusion, let me point out that the men in this room today represent more than mere agencies in the nation's money and credit mechanism, as important as they are. You as individuals are a vital power in forming the public opinion of the United States. In the aggregate, your influence is enormous. I do not expect you to agree with all the implications or conclusions of my remarks. I do ask you to think about the problems I have tried to spread before you. No one has all the answers; no one can now prescribe in full the course we should follow.

We must face the future with courage and with understanding. We must rest our faith on the conviction that freedom and the dignity of individual man will survive and we must be willing to fight to make that come true. In that spirit lies the hope that today's pain and struggle may be made only a phase in the evolution of a safer and better world - one in which freedom of thought and the institutions of human freedom have survived.