White House File

8/22/35

Mr. Stephen Early
Assistant Secretary to the President
The White House
Washington, D. C.

Dear Mr. Early:

In accordance with your recent request by telephone, I am transmitting herewith a statement on the financial and monetary policies of the Administration. This statement was prepared by Mr. Goldenweiser, the Board's economist, with the assistance of other members of the Board's staff, and I have been over it and have made suggestions that have been incorporated.

In my opinion it presents an excellent summary of the various phases of the Administration's financial and monetary policies. I wish particularly to commend it for the attention of the President.

I am also transmitting, in accordance with your request, a number of documents bearing on the subject, a list of which is attached to this letter.

Very truly yours,

M. S. Eccles
Governor

Eccles

Copy of original in Chester's file

Original sent to Mr. White Early at White House 8/23/35

Gov. Eccles:-

Two mimeographed copies of the President's memo. are attached. More available but being kept under lock & key.

Eccles.

CONFIDENTIAL

August 22, 1935

FINANCIAL AND MONETARY POLICIES OF THE ADMINISTRATION

In the early months of 1933 the forces of deflation, which had held the country in their grip for nearly four years, had finally resulted in an almost complete collapse of all economic activity: the banking system had broken down, prices of commodities were ruinously low, industrial activity had slowed down dangerously, the burden of debt was more than the nation could bear. The nation's economic life was almost at a standstill.

It was at such a time that the present Administration came into power. It was confronted by a choice of two ways of meeting the situation. It could let nature take its course, let the process of deflation be completed, let millions of people be ruined and run the risk of irreparable damage to our national life. There were many who favored this course and there are many now who think that if we had pursued it we would have advanced further toward recovery. But the cost in suffering would have been too great. Deflation had been allowed to carry the nation farther on the road to ruin than it had ever been before. Even if we could have rebuilt a sounder economic life on the ruins of the old, which is very doubtful, to say the least, there was no warrant for sacrificing the life and happiness of millions who were certain to be victims of the deflation for the benefit of those who might be fortunate enough to escape unscathed.

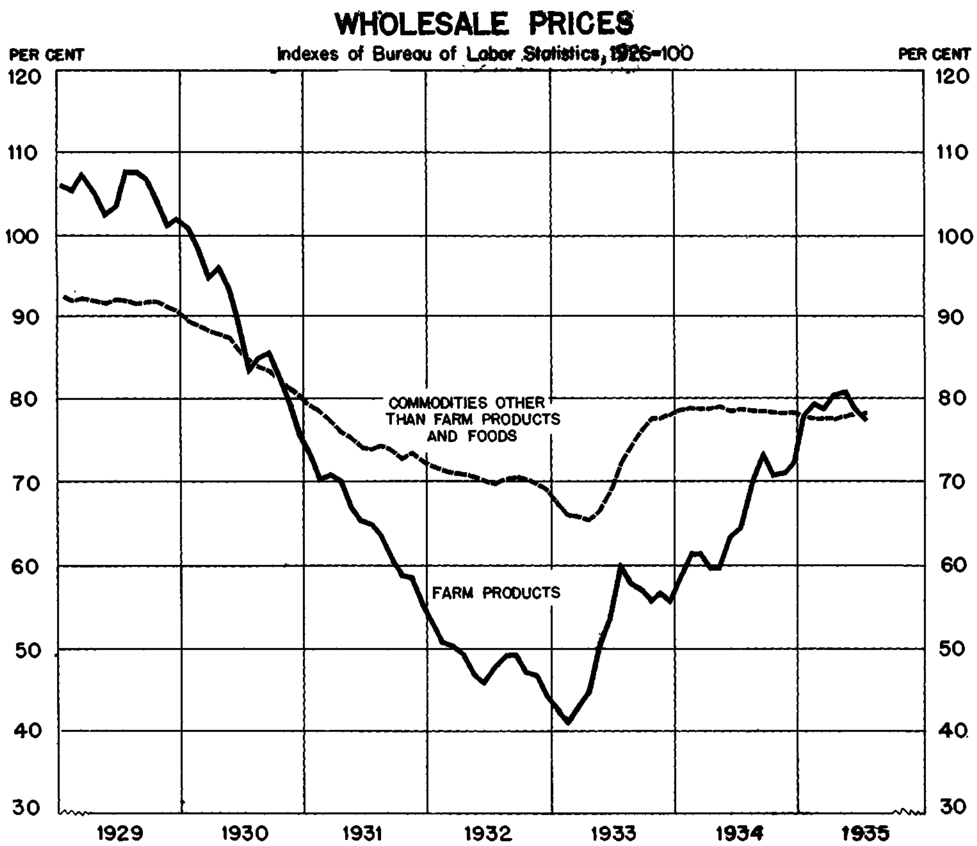
In fact, there was no choice. The Administration could follow but one course: to strain all its powers toward bringing about recovery, and in the meantime to do all that was humanly possible to mitigate the distress of the people. In broad outline, so far as financial and monetary policies were concerned, this meant to make every effort to raise prices, particularly of farm products, and not to allow adherence to the gold fetish to stand in the way of that accomplishment; to reduce the burden of private debt through refinancing urban and rural mortgages at lower interest rates; to take care of the distressed and the unemployed through relief and public works; to finance outlays for this purpose, not by increasing the burden of taxation, but by adding to the public debt to be repaid in prosperous times; to rehabilitate the banking system; and to encourage business recovery through the maintenance of easy money conditions.

MONETARY POLICY

As a first move in reconstruction it was necessary to depart from the gold standard, as most of the countries in the world had done. It was not possible to restore the prices of agricultural commodities to a reasonable level so long as they were linked through gold to depressed prices in the world market. To raise prices throughout the world was not within the Administration's power, nor was it its responsibility. To raise them for our producers alone was possible only if the link to gold were broken. There were other reasons for suspending gold payments: other undertakings for recovery would have been impossible if the timid holders of capital, whose chief concern is to protect their hoards, had been left free to convert them into gold and to send the gold abroad for safekeeping. This avenue of sabotage and frustration of our efforts for recovery had to be closed.

The Administration boldly abandoned the gold standard.

What were the effects on prices? From the summer of 1929 to February 1933 prices of all commodities had declined by 38 per cent, but, worse than that, prices of farm products, the things the farmers had to sell, had declined by 62 per cent, while prices of other commodities, including things the farmers had to buy, had fallen by 28 per cent. The farmer, on the average, had to dispose of close to twice as many of his products in order to pay for what he needed. This is graphically shown by the chart.



The gap between agricultural prices and other prices was enormous and it made it impossible for farmers to buy what they had to have for themselves and their families and to pay the charges on their debts. This gap began to close in the spring of 1933. It was closed, moreover, not by bringing other prices down to the level of farm prices, but by having all prices go up, with farm prices increasing faster than others, so that by this year they are all at about the same level in relation to the base year - 1926. The level may still not be satisfactory to everyone, but the improvement is striking.

There were other factors beside our gold policy that helped bring about this readjustment: there were the operations of the Agricultural Adjustment Administration, there was the drought, there was the increased demand for products caused by the economic revival. But the initial move and an important sustaining factor throughout the period was the readjustment between the gold value of the dollar and of other currencies.

By the beginning of 1934 it became apparent that this currency adjustment had been accomplished, first, by letting the dollar seek its level, later, by forcing it down somewhat by gold purchases at home and abroad. At the end of January 1934 the Gold Reserve Act was passed and the dollar was stabilized by proclamation at 59 per cent of its previous gold content. Since that time gold has been permitted to move freely in and out of the country in response to the needs of trade, but private hoarding of gold has been prohibited. And in returning to the practical operation of the gold standard, discretion has been retained for further changes in the gold content of the dollar if the national interest should demand it.

We have restored gold to power but its autocracy is now limited by a constitution, so that another economic collapse will not be necessary if the interests of the people should at any time demand another change.

As a part of the country's monetary policy, the Congress and the Administration decided to raise the price of silver to a better relationship to gold and to aim at broadening our monetary base by adding to it in the course of time sufficient silver to constitute at its monetary value one-fourth of the total metallic reserve. Largely as a result of this policy silver prices have advanced from 26 cents an ounce in the early part of 1933 to 65 cents in August of this year.

LIGHTENING OF THE DEBT BURDEN

In addition to making it easier for debtors to pay their debt charges by raising the prices of their products, a policy of refinancing debt at lower interest rates was vigorously pursued.

The Farm Credit Administration has refinanced over $1,600,000,000 of farm debts at lower interest rates which reduced total interest charges on these loans by about one-fourth. From a total of $1,600,000,000 in April 1933, total loans by the different agencies of the Farm Credit Administration have increased to $3,300,000,000 at the present time. Measures have also been taken for deferring and postponing payments on principal in many cases where this was necessary for the protection of both the farmers and their creditors. In cases of particular distress and injustice it has been found possible to write down the principal of the debt by a substantial amount, and in other cases to bring about an equitable settlement between debtors and creditors without foreclosures.

Similar relief has been extended to home owners in urban areas. The Home Owners' Loan Corporation has refinanced $2,700,000,000 of mortgages on homes at a rate of 5 per cent, representing a reduction from previous rates of between 1 and 3 per cent and in many cases more. It also has financed modernization and repairs of the mortgaged properties, surely a constructive undertaking. These refinanced mortgages have represented the borrowings of small home owners, as is apparent from the fact that the loans average only about $3,000 per home.

Permanent provision for sounder, more equitable, and cheaper financing of homes has been made by the establishment of the Federal Housing Administration. This organization provides machinery for insuring mortgages in order to improve conditions in the mortgage market and arranges easy financing for the modernization of homes. These activities contribute to the revival of building activity which is so necessary for recovery.

In addition to the relief for debtors, which was accomplished by reducing debt and lowering interest charges, a great deal was done to protect creditors where it was in the public interest and to strengthen the financial structure of many important enterprises whose continuous functioning was essential to the country's economic life. What was done for the banks is discussed in some detail later. In addition, the Reconstruction Finance Corporation, which had been organized in 1932, but whose activities were greatly expanded by this Administration, made large loans to insurance companies, to mortgage-loan companies, to railroads, and to the Commodity Credit Corporation.

FINANCING THE RECOVERY

In its efforts to relieve distress, to provide work for the unemployed, and to reduce the burden of debt, the Administration was under the necessity greatly to increase the Government's expenditures. It chose to do this during the depression chiefly by increasing the Government debt. This policy is sound, not only because it leaves the burden of payment for times when it can be borne more easily out of an enlarged national income, but also because by borrowing the Administration has put into operation forces that have contributed to increased buying power of the people, and have provided an important impetus to revival in business which is now apparent on all sides. That it has not weakened the credit of the Government is apparent from the unprecendentedly low rates of interest at which Government securities are absorbed.

The total interest-bearing debt of the Government increased from $20,600,000,000 in February 1933 to $27,900,000,000 in July 1935. As against this increase of $7,300,000,000 in the interest-bearing debt, however, there was an increase of $1,600,000,000 in the Treasury's available cash balance, of $1,800,000,000 in gold held for the Exchange Stabilization Fund, and of about $2,000,000,000 in the Government's interest in assets held by Government lending agencies. The net debt of the Government, therefore, increased by only $2,000,000,000. The largest single factor offsetting the increase in the gross debt has been the increment of $2,800,000,000 resulting from the revaluation of the dollar, an increment a part of which has been used in debt reduction and the bulk of which is available for that purpose whenever circumstances make it desirable.

While the public debt has increased materially in the past two years, the Government's actual carrying charges on the debt have increased very little because of the decline in interest rates. The average rate of interest on the Government debt declined from 3.4 per cent in February 1933 to 2.7 per cent in June 1935 and consequently interest payments increased by only ~~7~~ about 6 per cent although the debt itself increased by 34 per cent.

Some indication of how our situation compares with that of other countries in this respect is shown by the fact that the present interest payments constitute about 1 1/2 per cent of our greatly reduced national income in 1934 and less than 1 per cent of a normal income for this country, as against an interest cost for the British public debt of 5 1/2 per cent of the normal national income of the United Kingdom.

The comparison remains favorable to the United States, even if based on the debts of all governmental units, including local governments, which have a larger volume of debt in this country than in England. When all of these debts are taken into consideration, interest payments on these debts take 3 per cent of our reduced national income, as compared with 7 per cent of the normal national income in England.

A considerable part of the increase in the public debt has been purchased by the banks of the country, which have had abundant funds resulting from the easy credit policy of the Federal Reserve System and from gold imports with a relatively small opportunity for using these funds in other channels.

Financing Government expenditures through bank debt, within limits, is the most desirable way in a depression, because it is a way that does not use up existing funds but instead creates new money available for expenditures by the people. When the banks buy United States Government obligations they pay for them in effect by giving the Government credit on their books; when the Government disburses these credits it passes the funds on to the public. The large growth of deposits in the past two years has reflected to a large extent this process of United States Government security purchases by the banks and the subsequent expenditure of the funds by the Government.

Deposits are now nearly as large as in 1929 and the fact that business activity is still at a lower level is reflected in a smaller use of their deposits by depositors. With the revival of business, which is clearly under way, this so-called velocity of deposits will increase; the deposits are there to use, and they will be used when it will become profitable to check against them.

The table following shows the increase in the past two years in Government security holdings of banks:

Bank Holdings of Government Securities
(In millions of dollars)

	December 31, 1932	June 29, 1935
Federal Reserve banks	1,855	2,433
Member banks	6,540	9,871
Total	8,395	12,304

It may be observed, incidentally, that the proportion of the banks' earning assets that is in the form of Government securities is about 40 per cent in this country and about the same in England.

BANKING POLICY

On March 4, 1933, practically all the banks in the country were closed. All leading exchanges ceased operations and business in general was practically at a standstill.

On March 6 the President issued a proclamation declaring a nation-wide bank holiday to continue through the four days ending Thursday, March 9. An important purpose of this action was to attack the problem of bank failures comprehensively by reviewing at one time the condition of all banks and by reopening only such banks as could meet all demands upon them. This procedure was intended both to assure more equitable treatment as between the depositors who were making withdrawals and those who were not, and to restore confidence in the banking situation as a whole.

At the same time the President called a special session of Congress to enact such legislation as might be needed for the reopening of banks.

The Emergency Banking Act

On March 9, 1933, Congress assembled, and on the same day an emergency banking law was passed and signed by the President. It provided that when necessary for the conservation of the assets of a national bank the Comptroller of the Currency might place the bank in the hands of a conservator, whose powers differ from those of a receiver in that he is not under the same obligation to liquidate the assets as promptly as possible, a process that had contributed to the continued decline in the value of bank assets in general and had undermined other banks. The act also authorized the issuance and sale of preferred stock by national banks and the purchase of such stock by the Reconstruction Finance Corporation.

Rehabilitation

General rehabilitation of the banking structure began with the adoption and promulgation of the plan for reopening the banks after the banking holiday. A vital element in carrying this plan into effect was the public confidence created by the President's radio address on March 12 in which he gave the people the assurance that the banks reopened would be able to meet every legitimate call and that the Government was determined not to have "another epidemic of bank failures."

In accord with the Government's announced policy, the Secretary of the Treasury licensed during the first three days after the banking holiday 4,507 national banks and 571 State member banks, or about 75 per cent of all member banks of the Federal Reserve System. By April 12, State banking authorities had licensed approximately 7,400 nonmember banks, or about 71 per cent of the total number of such banks.

Increase of deposits

After the banking holiday in March 1933, 4,500 banks with deposits of about $4,200,000,000 were reported as not licensed to conduct an unrestricted business. The situation was dealt with rapidly. Many of the unlicensed banks, after receiving new capital, were reopened, while others were merged with active institutions. In some cases the best assets and a proportionate amount of deposits were drawn into newly chartered institutions and the old banks were placed directly in liquidation.

As the accompanying table shows, deposits in unlicensed banks were reduced to $1,000,000,000 by the end of 1933 and a year later had been reduced to negligible proportions.

In the two and one-half years following the banking crisis deposits in active commercial banks increased by $10,000,000,000 or more than 30 per cent. Including mutual savings banks whose deposits aggregate about $10,000,000,000, all bank deposits amount at the present time to more than $50,000,000,000, which compares with $55,000,000,000 in June 1929.

Number and Deposits of Licensed and Unlicensed Banks, Exclusive of Mutual Savings Banks

Date	Licensed banks		Unlicensed banks	
	Number	Deposits (000,000 omitted)	Number	Deposits (000,000 omitted)
April 12, 1933	12,819	30,932	4,194	3,978
December 30, 1933	14,344	32,230	1,769	1,025
December 31, 1934	15,370	39,910	158	88
June 29, 1935	15,400	41,200	64	43

Loans to closed banks

Another method to ease the situation was through advances by the Reconstruction Finance Corporation to depositors of closed banks. This method did much to relieve distress and to reestablish more normal activity of business. Depositors were given access to a part of their deposits which previously had been completely tied up. Authorization of loans for advances to depositors aggregated $1,000,000,000 between the end of March 1933 and July 31, 1935.

Recapitalization of banks

In order to rehabilitate the banking structure and to prepare banks for participation in the insurance fund, which was established in 1933, the Government determined in the course of the summer of 1933 to make liberal use of the authority possessed by the Reconstruction Finance Corporation to make investment in the capital of banks.

During the first few months following the banking crisis, this power was utilized chiefly in connection with bank reorganization for the purpose of extending essential banking services to communities that lacked such services, but during the summer of 1933 a broader program was adopted. The results of this program were becoming apparent in the last two months of the year. Many of the strongest metropolitan banks cooperated in the program, enlarging their capitalization by taking Reconstruction Finance Corporation funds. By the end of the year 1933 applications for additional capital had been received from about 5,000 banks, more than one-third of all active banks, and commitments with respect to capital investments aggregated $842,000,000.

At the end of last July, the Reconstruction Finance Corporation had investments aggregating $900,000,000 in the capital structure of about 7,000 banks.

Deposit insurance

The plan for the insurance of deposits, included in the Banking Act of 1933, approved June 16, introduced an important element into the process of rehabilitating the banking structure and a new feature of safety for depositors, particularly for small depositors.

When the insurance of deposits, under the Federal Deposit Insurance Corporation, came into effect on January 1, 1934, 12,617 banks were members of the fund. By the act of June 16, 1934, the temporary plan was extended to operate from July 1, 1934, through June 30, 1935, but provision was made to insure each depositor during this period up to $5,000. Mutual savings banks which continued membership were given the option of covering their deposits up to $2,500 or up to $5,000.

It was reported that on October 1, 1934, 44 per cent of the total deposit liability of insured banks and 98 per cent of the 51,245,000 depositors in these insured banks were fully protected under the provisions of the law.

It is estimated that at the end of last July there were about 15,800 active banks in the country of which 14,279 were participating in deposit insurance. Of these, 6,408 were members of the Federal Reserve System.

Bank suspensions

Reflecting the stability given the banking structure through the Federal insurance of bank deposits and the recapitalization of banks, bank suspensions in recent months have been at lower levels than at any time in the last fifteen years.

EASY MONEY POLICY

Throughout the period from the spring of 1933 the Federal Reserve System has continued to pursue a policy of monetary ease, which it had begun actively in the spring of 1932, when emergency legislation had made it possible to relax its eligibility requirements in exigent cases and to use United States Government obligations as collateral for Federal Reserve notes.

In March 1933 the volume of money technically known as in circulation was at an unprecedented level owing to the collapse of confidence in banks and the hoarding of currency. When the banks were reopened after the President's radio speech, currency began to be redeposited in the banks in large volume and by the end of July the money withdrawn during the panic had all been returned to the banks. It is beginning with that date that the credit policy of the Federal Reserve System during this Administration can best be considered.

From July to November 1933 the Federal Reserve banks purchased $400,000,000 of United States Government securities carrying the total to over $2,400,000,000. A part of the funds released in this way was added to the excess reserves of member banks. Excess reserves mean that banks have funds which they are not required by law to keep idle and which are, therefore, available for the extension of credit. By the autumn of 1933 the member banks had $800,000,000 of such idle reserves. Since that time they have increased still further: they are now in excess of $2,500,000,-000, notwithstanding the fact that the banks' deposits, and consequently the reserves that they are required by law to keep, also increased considerably.

This increase in reserves, over and above the security purchases by the Federal Reserve banks, has represented largely the effects of the inflow of gold from abroad and, to a minor extent, of the issuance of silver certificates by the Treasury. There has been an inflow of gold from abroad, which has amounted to $1,900,000,000 since this Administration came into office, reflecting to a large extent the return flow of American funds from abroad and the flight of foreign funds to this country. This movement of funds shows clearly the confidence that both Americans and foreigners have in the dollar, that is, in the monetary and financial conditions in this country.

In view of the rapid growth of reserves through gold imports, the Federal Reserve System after the autumn of 1933 did not pursue further its policy of open-market purchases, but allowed the gold inflow to have its full effect on bank reserves. It also contributed to monetary ease by reducing the discount rates to 1 1/2 per cent in New York and not more than 2 per cent at any other Reserve bank, and by reducing the maximum rate to be paid on time deposits to 2 1/2 per cent.

As a consequence, money rates everywhere went down. For example, open-market rates on acceptances declined to 1/8 per cent; yields on high-grade corporate bonds declined from 4 3/4 to 3 3/4 per cent and yields on Treasury bonds from 3.44 to 2.60 per cent. The effects of these low rates on Treasury financing have already been mentioned. Recently they have led to a large volume of refunding by corporations, which is another step in the reduction of the burden of debt.

Another activity of the Reserve banks to help in recovery has been the granting of some $100,000,000 of credits for working capital to industrial concerns, an activity that was authorized by a special act of Congress in 1934.

NEW BANKING LEGISLATION

Experience has demonstrated that our banking administration was not well adapted to the needs of the country under modern conditions.

In order to remedy this condition the Administration proposed the Banking Bill of 1935 which after prolonged consideration in the House and in the Senate became law on August __.

This law marks a great advance in our monetary administration because it recognizes that monetary policies are a national, and not a regional or private concern, and consequently concentrates responsibility in these matters on the Board of Governors of the Federal Reserve System in Washington.

The new law also removes some of the restrictions which had limited the kind of paper on which the Reserve banks could make advances to member banks. The removal of these restrictions will not only enable the Reserve banks to be of greater service to their member banks in times of depression, but it is hoped that it will give the member banks greater courage in meeting the needs of their communities for long-time as well as short-time credit. Authority for the nation's banks to make loans on real estate has also been liberalized — and it is hoped that this will encourage the banks to contribute more to the revival of building activity, which is essential to recovery.

With the adoption of the Banking Act of 1935, together with the authority to restrain speculation under the Banking Act of 1933, and the control of security markets and margin requirements under the Securities Acts of 1933 and 1934 — we are in a better position than we ever have been to prevent disastrous expansion and contraction of credit and to moderate the booms and depressions in the country's business.

FINANCIAL AND MONETARY POLICIES OF THE ADMINISTRATION

Documents

Reports

1.	Federal Reserve Board	1933
2.	Federal Reserve Board	1934
3.	Federal Deposit Insurance Corporation	1934
4.	Secretary of the Treasury	1932-33 (fiscal year)
5.	Secretary of the Treasury	1933-34 (fiscal year)
6.	Reconstruction Finance Corporation	1st quarter 1935
7.	Farm Credit Administration	1933
8.	Farm Credit Administration	1934
9.	Federal Home Loan Bank Board	1933
10.	Federal Home Loan Bank Board	1934
11.	Federal Housing Administration	1934

Bulletins

12.	Federal Reserve Bulletin	June 1935
13.	Federal Reserve Bulletin	August 1935

Statements on Banking Bill of 1935 by Governor of Federal Reserve Board

14.	Summary of Statements before House of Representatives Committee	
15.	Statement before United States Senate Committee	
16.	Radio address	May 25, 1935

Addresses and messages of the President dealing with financial topics

1.	Message to Congress	March 9, 1933
2.	Message to Congress	March 10, 1933
3.	Radio address	March 12, 1933
4.	Message to Congress and Executive Order	March 27, 1933
5.	Message to Congress	April 3, 1933
6.	Message to Congress	April 13, 1933
7.	Radio address	May 7, 1933
8.	Message to London Conference	July 2, 1933
9.	Radio address	July 24, 1933
10.	Message to Bankers' Association	September 5, 1933
11.	Radio address	October 22, 1933
12.	Message to Congress	January 3, 1934
13.	Message to Congress	January 15, 1934
14.	Message to Congress	May 14, 1934
15.	Message to Congress	May 15, 1934

Addresses and messages of the President dealing with financial topics (continued)

16.	Message to Congress	May 22, 1934
17.	Radio address	September 30, 1934
18.	Address before Bankers' Association	October 24, 1934
19.	Message to Congress	January 4, 1935
20.	Radio address	April 28, 1935
21.	Message to Congress	May 22, 1935
22.	Message to Congress	June 19, 1935
23.	Message to Congress	June 27, 1935
24.	Address to State Directors of Federal Emergency Public Works Administration	July 9, 1935

Addresses by Secretary Morgenthau

25.	Radio address	August 28, 1934
26.	Radio address	May 13, 1935

Address by Comptroller of the Currency

27.	Excerpts from address before Michigan Bankers' Association	June 26, 1935