TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE: June 16, 1934

TO Mr. Eccles

FROM Edmiston

Re: Treasury Control of Inflation and Deflation

Treasury Powers to Control Inflation

During a period of credit expansion and increased business activity, the revenues of the Government normally expand. It is customary at such times for the Treasury to retire bonds which reach maturity, or are callable. Funds not used in bond redemption and current expenditure are deposited in commercial banks. These operations in themselves have no effect at all on the total credit base.

However, the Treasury may choose to withdraw the funds it receives by depositing at the Federal. This draws down member bank reserve balances and forces the banks either to borrow at the Federal, or to contract loans and investments and hence contract deposits to levels at which present reserves would be adequate.

This analysis assumes that the Federal Reserve would not, by open market operations, nullify the action of the Treasury. With two (nominally at least) independent bodies having central banking functions there may be conflicts as to credit policy.

Of course, to obtain the best control over the credit situation, the Treasury and the Federal Reserve should agree as to policy and cooperate in carrying it through with the powers available to both.

Treasury Powers to Counter-Act Deflation

Stabilization Fund

The funds acquired by the profits from dollar devaluation provide the

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Treasury with a powerful weapon to meet deflation. By putting these funds out member banks receive cash which may be used to loan. In any event, reserve balances are increased and pressure of contraction, which may be present, is relieved. Moreover, if the Treasury uses the funds by placing them into the hands of spenders, there is at least one turn-over through business channels, thus giving much needed stimulation to business in addition to increasing the banks' reserves and cash.

## Borrowing Operations

I pointed out in the Federal Reserve memorandum that the Federal can put funds out to the banks, but the banks themselves choose whether or not to use them and we have just experienced a period where merely having excess reserves has been an insufficient inducement to new lending. The Treasury on the other hand does have power to place funds into the hands of spenders thereby giving impetus to business activity and promoting recovery. By selling securities which the banks buy (for numerous reasons in such a period), the Government obtains deposits to check against. How effective in checking deflation and stimulating business the measure will be depends largely upon how the Government spends the funds and what channels they move after the first turn-over.

This memorandum just hits the high spots of the effects of the Treasury's ordinary operations without going into the broader powers of taxation and issue of money as affecting income distribution and business activity.

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