

October 27, 1942.

Dear Henry:

You may have seen the article which **TIME** printed while you were abroad. It was such an outrageous misrepresentation that I could not refrain from protesting to Mr. John Davenport, one of the editors, in a letter, copy of which I enclose for your information.

Sincerely yours,

Honorable Henry Morgenthau, Jr.,  
Secretary of the Treasury,  
Washington, D. C.

Enclosure

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C O P Y

October 27, 1942.

Mr. John Davenport,  
Associate Editor,  
Time Magazine,  
Time & Life Building,  
Rockefeller Center,  
New York City.

My dear Mr. Davenport:

TIME'S report on the Treasury's recent four-billion-dollar financing operation is so unfair and such a disservice to the country that I feel compelled to send you this protest, inasmuch as you telephoned me while I was in New York and I assume you had some responsibility for this article.

To state, as TIME'S article does, that this financing was an "outstanding failure" is a gross misrepresentation. To assume, as this article does, that under wartime conditions there should still be the enormous oversubscriptions that characterized the pre-war era, when the banks were inundated with excess reserves and idle funds, is to start with a wholly false premise. Moreover, the article assumes that nonbank investors were expected to subscribe to most, if not all, of the recent 2 per cent bonds of 1950-1952, whereas, in fact, this issue was designed primarily for the banks, though to be sure, it was desirable to sell as much of it as possible to nonbank investors as well. The 2-1/2 per cent long-term open-end issue, which has been offered and probably will be reopened, has been designed for nonbank investors and the banks have been prohibited from subscribing to this issue. Likewise, the Series E, F and G Bonds are available to all investors except banks. The new tax notes are also designed in part for the investment of idle nonbanking funds.

The Secretary of the Treasury was entirely right, in my opinion, in what you stigmatize as his "little homily on 2 per cent financing". Of course, many banks would have welcomed not only "2-1/4 per cent bonds of 12 to 14 years' maturity", as you state, but doubtless would have welcomed an even higher coupon of 2-1/2 or 3 per cent, or more. But the wisest bank judgment has been ably expressed by the Economic Policy Commission of the American Bankers Association in a statement made in April which frankly recognizes that the Federal Reserve System and the Treasury are supplying the banks with the reserves with which to make purchases of Government securities.

It emphasized the difficulties that would be encountered, particularly in the post-war era, should the banks be heavily invested in long-term securities, and it stated:

"One proposal, therefore, to safeguard this situation is that the securities offered the banks should be wholly of very short maturities of perhaps one to five years and hence subject to only modest fluctuations even with a considerable change in the market. The difficulty with this proposal is that under it the Treasury would have a huge floating debt which has to be renewed embarrassingly often, at the same time that large additional issues for new money are being floated.

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"A more realistic suggestion would be the sale to the banks of maturities ranging from one year to about ten years. This would have the effect of spreading out Treasury maturities and would give the banks well distributed portfolios with a fair yield and some market outside the banks. With obligations up to ten years and an average maturity of less than five years the banks would not be exposed to serious fluctuations in values."

The judgment of the ABA economic policy group coincides with that of the Secretary of the Treasury and of the Reserve System. It was for this reason that the 2 per cent ten-year issue was offered and the banks put on notice that they need not expect a higher rate or longer term maturities.

Desirable as it is, in order to avoid inflationary financing, that as much as possible of the cost of the war be met by taxation and by borrowing out of current income from nonbank sources, it is inescapable that the banking system will have to do a substantial amount of the financing. Under present prospects it is estimated that about \$30 billions of new debt may have to be absorbed by the banking system in the current fiscal year. Under the present pattern of interest rates, ranging from 3/8th's to 2 per cent for banks, the return to the banking system in interest alone will amount to some \$150 millions.

It would be short-sighted policy for the banks to seek abnormal profits from war financing. The return to which I have referred would seem to be adequate compensation to the banks for the creation of this money supply based upon reserves furnished to them by the Government. This is especially true in the light of the recurrent political pressures seeking to have the Government finance itself through non-interest bearing issues sold to the central bank.

Had a 2-1/4 per cent 14-year maturity been issued, as your article advocates, then to the extent that the banks had taken this issue, they would have taken that much less of the shorter maturities in line with the sound policy advocated by the American Bankers Association. Both in England and in Canada this basic principle of bank financing of the war is recognized and adhered to. In effect, the governments of those countries are compensating the banks by giving them what amounts to a living wage, not a large profit-making return, for the services they are rendering.

The theory upon which TIME'S article appears to be predicated is that wartime financing is like peacetime financing and that rates should remain uncontrolled, notwithstanding the controls placed upon all other elements in the economic picture, including labor, agriculture and prices in general.

In the pre-war period, when Treasury offerings were priced at a sufficient premium above the market to insure a substantial profit in their underwriting, there were heavy oversubscriptions, known as padding, by the banks, security dealers and others, which did not reflect a true investment demand but rather the speculative opportunity for a quick turnover at a profit. These subscribers did not expect to receive the full amount of their subscriptions, a fact that tended to add to the amount of the oversubscriptions.

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In contrast with this, the 2 per cent issue, which you castigate, was offered at par. The subscriptions represented a non-speculative investment demand. There was no incentive for padding and hence there was no padding, and subscribers expected to get the full amount of their subscriptions.

TIME'S article proposes an "over-all rise in interest rates". This again reflects a lack of understanding of wartime conditions and the situation with which we are confronted. As the ABA report to which I have referred rightly emphasizes, it is important that the war be financed "on a fairly stable level of interest rates", and adds, "The Treasury, moreover, would be handicapped in its financing program if succeeding issues of bonds appeared at sharply rising interest rates. Investors would be tempted to wait for better rates. Such a tendency would be natural in view of the fact that the present interest rates are the lowest in the history of this or any other country."

In various other particulars TIME'S article is misleading as, for example, in implying that selling Government securities to a central bank is disastrous to the economy, whereas selling them to the commercial banks would not be. The fact of the matter is that the same amount of new money would be created in either case.

I enclose a copy of a letter to customers issued by a prominent bond house in Chicago which takes just the opposite view from that expressed by TIME'S article.

As I said at the beginning and as I wish to repeat, this article is a distinct disservice to the country in its prosecution of the war.

Very truly yours,

M. S. Eccles,  
Chairman.

Enclosure

From Bond Comment, by Wayne Hummer & Co., Chicago -

"There are certain groups interested in the Government bond market who believe that the war must be won but it must not in any way inconvenience them nor disturb their usual mode of business. In fact, among a great body of citizens (fortunately growing smaller) who still believe in 'business as usual' this group is the most vocal. It has been very apparent, to the observing, ever since the outbreak of World War II in 1939 that the Treasury and the Federal Reserve authorities had in mind a definite program for financing the Nation's war needs, if and when war did come. Since our entry into the war, Government financing has followed that general pattern. As a result of that foresight and that preparedness, the Government bond market since Pearl Harbor has been stable and orderly and has absorbed astronomical amounts of new securities without a tremor. This orderliness, of course, was fatal to the activities of that group who believe that the Government bond market is a legitimate place for security speculation and that Government bond prices should be in a continual state of ferment in order that their speculative activities could proceed as usual. At the time the October financing was under discussion this group urged that the Treasury offer a  $2\frac{1}{4}\%$  bond. Such an offering, of course, would have disturbed the orderliness of the market, would have attracted a large over-subscription and again probably have revived the 'free rider' problem. The Treasury and the Federal Reserve authorities decided to adhere to their original program and to the program for a 10 year deadline on maturities for commercial banks, developed by the bankers themselves in the report made public last April by the Economic Policy Commission of the American Bankers Association, and offered a  $2\%$  bond due in 8-10 years. This was a wise decision. The October financing was successful and well received in view of the stiff opposition it met in certain quarters. This group continues to be very vocal in their opposition to the Government's program which, incidentally, was publicly announced by Mr. Morgenthau last week. We are in complete accord with the Government's announced program and we are sure that program will be successful. Many bankers are prone to forget that if the Treasury had acceded to the high coupon advocates at this time, it would only be a short while until a  $2\frac{3}{8}\%$  coupon would be demanded, then a  $2\frac{1}{2}\%$  and a  $2\frac{5}{8}\%$ , and so on until our Government war finance pattern would have been the same as it was in World War I. A program of ever higher coupons could only be destructive to the price stability of the Government market. Government bond price stability is what we need more than any one thing in the period ahead when the ratio between bank capital and bank deposits will be ever widening."



TREASURY DEPARTMENT  
OFFICE OF THE SECRETARY  
WASHINGTON

October 29, 1942.

Dear Mr. Eccles:

In the absence of the Secretary, who is still abroad, I am acknowledging your letter of October 27, enclosing a copy of one you have written to Mr. John Davenport, Associate Editor of TIME magazine.

I shall be very glad to bring these communications to Mr. Morgenthau's attention immediately upon his return to the office.

Sincerely yours,

H. S. Klotz,  
Private Secretary.

Honorable Marriner S. Eccles,  
Chairman, Board of Governors of the  
Federal Reserve System,  
Washington, D. C.