

Sept. 21, 1944

CRITICISM IN CONGRESS OF BANK EARNINGS ON GOVERNMENT DEBT

There is reason to expect that Mr. Patman and his following in Congress may renew pressure to have the Reserve System finance, without interest, further increases in the public debt that would otherwise add to earnings of commercial banks.

Up until last Spring, Mr. Patman and his group had for some years repeatedly spoken in Congress and by radio in favor of having the Government finance all deficits by issuing non-interest-bearing bonds. He and his group charged that the Reserve System was dominated by the private bankers and emphasized the sovereign right of the Government to finance itself without interest if it decided to do so. All of this led me to address an open letter to Mr. Patman on March 21, 1941, to counter his argument and point out, among other things, the truism "that someone must pay for everything", that banks were not making inordinate profits out of Government financing, and that they could not be expected to operate on a sound basis with less income. I emphasized that in the 10-year period, 1930-1939, the average rate of net earnings on invested capital by member banks was 2 per cent, which was less than a reasonable rate of return. I mentioned also the depressed market for bank stocks as evidence that the banks were not unduly profiting from Government financing.

Time and again, in hearings before House committees, Mr. Patman had something of a field day catechizing me on this general theme. Subsequently he moderated his view, and at the hearing on April 5, 1943, before the House Banking and Currency Committee on the bill to exempt war loan accounts from FDIC assessments and from reserve requirements, Mr. Patman for the first time publicly, to my knowledge, accepted as justifiable a sufficient income for the banks from Government financing to sustain them, but served notice that when bank earnings from this source reached greater proportions both from new financing and refinancing than he would consider justified, he would advocate having the Reserve System absorb without interest issues that otherwise would yield returns to commercial banks,

It should be borne in mind that Mr. Patman is well-informed, persistent, and capable of leading a formidable group in Congress as well as of influencing public opinion on the outside. What seems to be his present attitude cannot be dismissed as belonging in the crank category. Despite my efforts to head him off, he persistently hammered away, at the April 5 hearing, on the point that the Reserve System could finance without interest the Government debt beyond what would net the banks a reasonable living. He asked whether I had "given consideration to any plan, or tried to devise or formulate any plan, that would enable the Government to do any part of its financing without the payment of interest".

He pointed out that if the Reserve Banks could buy up to \$5 billions, as authorized, of interest-bearing debt directly from the Treasury, there was no reason why it could not buy that much and more of non-interest-bearing debt. When I sought to draw him off into the question of why,

logically, he did not propose to finance all the debt without interest, he replied:

"There is a good reason for that. I am opposed to that. I am in favor of selling all the bonds you can sell to the people that have the money to buy them, or the corporations. I am in favor of considering just as high a tax as possible to pay off as much of this debt as we can, but after we have sold all the bonds we can to people who have the actual money to buy them, and we have raised all the money through taxes that it is possible to raise, a lot of bonds will have to be sold at about 45 to 50 percent of the amount of money we use, and that will be obtained by letting the commercial banks create that money just by a flick of the pen, and we will be in this position of having a perpetual debt on our hands. If this debt gets to be \$200,000,000,000 or \$300,000,000,000, as many people think it will, the debt for interest alone will be from \$5,000,000,000 to \$7,500,000,000 a year just for interest. It occurs to me that this Congress will be falling down in its duty if it sits idly by and permits this money to be created in that way and obligates the people and the taxpayers to forever pay the interest. It just does not make sense to me."

I recurred to the point that bank earnings for the year 1942, despite the large increase in Government holdings, were less than in 1941, and that it did not make up for the shrink in bank loans. He apparently was satisfied for the time by this line of argument, but continued to press as to my attitude in case the picture changed. I stated that: "There may be a point where the earnings of the banking system are more than adequate to take care of their increasing expenses, together with a reasonable return on capital", but that the trend was the other way at the time and his argument, therefore, academic.

He insisted that at some point the bank earnings from Government debt would be excessive, and said he was "disappointed that Mr. Eccles refuses to give consideration to it; he insists on closing his eyes and not trying to solve the problem at all." He added that he could not understand why the Federal Reserve "officials" do not "give some consideration and try to save a large part of that interest."

I replied that, "When the problem of excess profits of the banks begins to appear, you will find me just as diligent about attempting to avoid profiteering on the part of the banks as we have been to prevent profiteering by anyone else."

He remarked that "you are not thinking about the taxpayers", and after referring to the fact that the capital stock of all banks amounted to \$3-1/2 billions (this would not include surplus and undivided profits), he said:

"Now, you already have the Government in this position, which I consider is a position that cannot be justified, of encouraging the sale of bonds to the banks to the extent that by the end of the next fiscal year these banks that have a capital stock investment of 3-1/2 billion dollars will be receiving from 1 to 2 billion dollars a year interest on the Government obligations they will then hold. Now that does not seem to make sense to me.

"So I am apprehensive that one of these days the banks will have so many Government bonds upon which they receive interest that there will be a clamor in this country, 'Why pay the banks 3-1/2 billion dollars a year interest when they only have 3-1/2 billion invested in capital stock; why not take all of the banks over and save that 3-1/2 billion a year interest?' I am in favor of the private banking system, of free enterprise, and I think the banks are doing something against themselves when they place themselves in that vulnerable position."

"What would you suggest," I asked, "to take the place of the interest that these banks now receive on Government securities?"

He replied, "I would permit them to receive a certain amount that is reasonable, but I would have the date fixed and, if that was not satisfactory, I would fix another date."

When I pointed out that the banks then held a large amount of short-term debt with low yield, Mr. Patman retorted, "You are talking about the short-term debt, but you know there will be a refinancing and these certificates will be refunded probably with long-term bonds drawing a much higher rate of interest."

The foregoing, from the printed hearings, reflects only highlights in an extensive catechism in which several committee members of both parties indicated a disposition to side with Mr. Patman. That the matter was prominently in his mind, was indicated again on February 9 of this year, when at a hearing on the Brown-Maybank Bill, he interjected the following (page 675):

"Well the banks are pretty well taken care of; they are pretty well provided for, and it won't be long before the banks will be in a very vulnerable position, when the point is reached, as it doubtless will be reached, that they will own so many Government securities that the interest on those Government securities will amount to as much as their entire capital stock is. And when they reach that point, they are in a very vulnerable position, and some fellow might get up over here on the floor of the House and say 'Why pay these fellows a billion and a half or two billion dollars of interest; why not buy them up and buy the stock, and save all this interest every year.'"

While Mr. Patman and his group probably could not get far at any time with their original program for financing all deficits without interest, their revised program, conceding the need to sustain the private credit system, but proposing to rely on the Reserve System to finance the debt without interest once that need has been met, presents issues which can hardly be ignored in the light of the current situation.