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March 25, 1935.

Mr. Edward B. Boies,
The University Club,
1 West 54th Street,
New York, N. Y.

Dear Sir:

I wish to acknowledge receipt of your letter of March 20, regarding certain parts of my testimony before the House Banking and Currency Committee.

Apparently you received an erroneous impression from my comments upon the methods of financing government deficits. The difficulty is due, I believe, to your misconception of how the banking system operates in the creation and extinguishing of money (deposits subject to check). In a period when bank loans are being called or voluntarily paid off without new loans being made, demand deposits are correspondingly diminished. Thus, individuals and corporations have surrendred their claims to the current output of goods and services. The effect of this process of deflation upon business activity, employment, incomes and prices, is clear.

I advocate government deficits in a period of depression as the most feasible method of increasing incomes and stimulating business recovery. To accomplish these results, it is essential that the governmental expenditures shall be financed with funds that would not otherwise be spent; that is, either by purchase of government obligations by commercial banks thereby creating new deposits subject to check or by the securities being sold to holders of unused deposit balances. For banks to purchase governments definitely does not mean that depositors' funds are being taken over by the government as you interpreted my statement to mean. The banking system in buying government securities sets up checking accounts (book entries) which the government may draw upon to make payments. Thus, new deposits are created and the total money supply of the country is augmented. In effdct, it simply is the replacment of money which previously had been destroyed in the process of deflation and liquidation, which would

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probably not take place without a government deficit being created. Through the government paying out the funds into the channels of trade and industry, business activity and employment are increased and the national income enlarged.

For the banks to refuse to cooperate in financing such a governmental spending program would indeed be unfortunate. There is no question of the government's power to provide the necessary funds either by the issuance of currency or the establishment of banking facilities of its own. One of the first powers given to the Federal Government by the Constitutional Convention was the power "to coin money and to regulate the value thereof". With the development of deposit banking, commercial banks have obtained the power to create and destroy money without the fact being generally realized either by the bankers themselves, by the government, or by the people of the country. In this connection I might quote from President Woodrow Wilson, who said in his address to the joint session of Congress in 1913: "The control of the system of banking and of issue . . . must be vested in the Government itself, so that the banks may be the instruments, not the masters, of business and of individual enterprise and initiative". President Roosevelt stated a similar thought in his speech before the American Bankers' Association last October - "The old fallacious notion of the bankers on the one side and the Government on the other as more or less equal and independent units has passed away. Government by the necessity of things must be the leader, must be the judge of the conflicting interests of all groups in the community, including bankers." I call these statements to your attention merely to point out the fundamental necessity of the banks' cooperation with governmental policies which are designed to promote the welfare of all of the citizens of the country.

I hope that these brief comments will give you a better insight into my views on the question which you raise.

Very truly yours,

(Signed) M. S. Eccles

M. S. Eccles,
Governor.

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