

February 22, 1943

Chairman Eccles

Report of Economic Policy Commission

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The draft of the report submitted by Mr. Burgess is in my opinion highly constructive. I am giving first a general summary of the contents of the report and second a few specific details that you might wish to call to Mr. Burgess' attention. I do not think that you should indorse the report in its entirety, because there are a few implications that you might not favor, but the general tone of the report is highly satisfactory.

After discussing the new budget, the report considers the inflation threat and the various methods being used to meet this threat including price control and rationing, taxation, bond sales, and voluntary savings. The conclusion is drawn that the program of selling Government securities must reach more individuals and especially those individuals who are receiving the bulk of the newly-created funds. In the next drive it is stated that the banks will be looked to for leadership and accomplishment, that the best results will be obtained from personal interviews by bankers and investment bankers, that more preparation must be made ahead of time, and that the approach to bank depositors must be supplemented by appeals to individuals in their places of employment and through their religious and social organizations. The report then explains that banks will not be harmed by pushing sales of Government securities to their depositors, since the deposits that are lost through the sale of Government securities ~~generally~~ come back to the banks through other accounts. It is also stated that despite their loss of personnel the banks should cooperate fully both on grounds of patriotism and on grounds of enlightened self-interest. The latter point is explained by the argument that customers want to associate themselves with institutions that are vigorous and energetic and are performing their banking function in a broad way and more generally that the present financing program affords an opportunity to demonstrate the public usefulness of the private banking system.

The report then states that even after the best possible efforts to sell securities to their customers the banks themselves will be called upon to absorb a substantial amount of Government securities. It explains how banks can buy securities far in excess of their excess reserves because of open market operations and reductions in reserve requirements by the Federal Reserve System. It then states that if individual banks find themselves short of reserves they can meet this situation through selling bills or certificates. The report also states that there is clearly no odium attached to borrowing and that it would rather be a sign that a bank is prepared to do its share in the war financing.

Regarding each bank's share of the financing, the report states that banks should now be fully invested and can subscribe to new issues even though they have no excess reserves. It is suggested that banks should determine their own subscriptions on the basis of the ratio of holdings of

Government securities to total deposits, which is now nearly 50 per cent for the country, and on the basis of the ratio of their deposits to the total for the country. Regarding the possibility that deposits may disappear, it is pointed out that the current expansion of deposits is due to increased holdings of Government securities and that the deposits will normally be liquidated as these securities are redeemed by the Government or are sold to other investors, whereas the decline in deposits in 1920 and 1921 followed a period of expansion in commercial loans, which were liquidated as commodity prices declined. The answer to the individual bank problem of possible losses of deposits to other banks lies in purchasing bills and certificates, which can always be sold promptly.

Regarding the banking structure and the decline in capital ratios, the report states that the decline in loans and investments other than Government securities represents a reduction in risk and that purchases of short-term securities minimize the price risk in holding Governments. In addition it suggests that banks should seek to increase their capital from earnings and later by obtaining new capital in the market and that they should follow a conservative policy in handling doubtful assets and in the payment of dividends. Regarding the danger of the large debt the report states that it is a risk that we have to take in war and that the more immediate danger is the expansion of bank credit. In reducing this danger the report states that banks can sell bonds to nonbanking investors and can encourage the doctrine of saving.

Regarding some of the specific points, at the top of page 3 there is a political implication that might better be omitted. On page 6 a comparison of the nonbanking funds raised in the December drive is made on the basis of total deposits, and the implication is drawn that the New York District did the best selling job of all and some of the other Districts did a very unsatisfactory job. I think that this comparison might well be omitted. On page 10 the estimate of sales of Government securities to nonbanking investors from January through June 1943 is lower than actual sales from July through December 1942. If the table is included in the report, it should be made clear that this assumes that a relatively unsatisfactory job will be done in April. On page 13 I doubt whether the percentage of a bank's deposits that is invested in Government securities is a satisfactory measure of the amount that should be subscribed for new issues in view of the wide differences in individual bank loan portfolios. In addition to deposits subscriptions might be based on excess reserves and bankers balances. On page 19 it is stated that all that the Government can do in stabilizing business is to alleviate the swings a little.

On page 2 the word "civilian" should be inserted before "spending". On the same page the implication in point 3 is that bond sales to the people are involuntary. On page 5 it is said that sales of securities to commercial banks are directly inflationary, which seems to me to be an overstatement. On page 15 there is an implication that only banks may use the buying and repurchase provisions on bills.

