April 22, 1939

Honorable James C. Oliver,
House of Representatives,
Washington, D. C.

Dear Mr. Oliver:

This is in reply to your letter of March 16 in which you raise some questions about the Board's statement on proposals to maintain prices at fixed levels through monetary action. In the first place, I should like to call to your attention a more recent statement of the Board, issued on April 8, which may be taken as a supplement to the earlier statement. In this statement the Board proposes "that Congress through appropriate committees or a joint committee take steps to determine the objectives by which monetary and banking authorities shall be guided, the validity of different plans and views on monetary and credit matters proposed or held by agencies within or outside the Government, including the Board's own position, and the character of governmental machinery that would be best calculated to carry out the purposes of Congress in this important field." A copy of this statement is enclosed.

The Board has always recognized the important role that monetary action can play in influencing the course of business activity, employment, and national income, and since the beginning of the Reserve System has endeavored to pursue policies that would help to maintain economic stability. The recent statement, concerning which you have written, was for the purpose of pointing out some of the limitations on the effectiveness of monetary action and to raise the question whether price stability should be the sole or principal objective of such action. It is the Board's belief that the ultimate objective should be economic stability and that in order to achieve it cooperation between many agencies within and outside the Government is essential.

This view of the Board is illustrated by the developments to which you refer in your letter. Monetary action aided in financing the war, and policies pursued by the System in the 1920's aided in financing the reconstruction of the world after the war. In the recent depression period, monetary action has been much more vigorous than in those periods;

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an abundant supply of money has been maintained and interest rates have been reduced to the lowest levels in history. That, notwithstanding the abundance and cheapness of money, business has been less active in recent years than in earlier periods shows that there were retarding factors other than the supply and cost of money. During the war there was an active demand for money, for financing the production of needed materials, and during the post-war period it continued in active demand in various highly profitable private activities. During these periods, in fact, unsound uses of credit for speculation in commodities, real estate, and securities developed, which led to later difficulties.

The heart of the present problem is contained in the discussion of idle funds, beginning on page 6 of your letter. The failure of the public to make active use of the idle funds which it holds in the form of currency and deposits is the crux of the difficulties which we face in our current efforts to further business recovery by monetary means. As you state, deposits which are idle are not effective in influencing the course of business activity and the volume of national income, and the same is true of hoarded currency. Since 1930 there has been an increase of something like $1,000,000,000 in currency of large denominations reported as in circulation. Most of this is undoubtedly held idle in private hoards. In addition to the amount of currency in circulation and deposits in banks which are not being actively used, the banks have nearly $4,000,000,000 of excess reserves. These excess reserves are money on which banks would like to earn interest but for which they can find no satisfactory employment. The banks are offering these funds at rates of interest far below those charged in the 1920's. In short, both the banks and the public with more funds than ever before are finding it impossible to invest them all. Funds currently being made available through the inflow of gold are piling up as hoarded currency, unused deposits, and idle bank reserves. This is the problem to which you call attention in your letter and which the Board has frequently discussed in its official publications.

Although recent experience shows that sizable additions to bank reserves and deposits do not suffice alone to stimulate a vigorous and sound business expansion, it is, of course, impossible to forecast the ultimate effects of adopting a program involving tremendous additions to the supply of money and bank reserves. In my opinion, such a program would tend to create a condition of fear and uncertainty in business and financial circles that would rapidly spread to the general public. As the country was literally flooded with money, the confidence of the public in our monetary system might be shaken to such a degree that inflationary psychology would develop. In such circumstances, there might be a rush by the public to convert money into commodities and equities that would result in a speculative boom. Once a movement of this type gains headway, it is virtually impossible to regain control of the situation. Any attempt to do so runs the danger of precipitating a violent collapse in prices and business. Yet to permit the movement to run its course uncontrolled would be to invite an even more demoralizing collapse.

To my mind, therefore, it would be irresponsible public policy to adopt a program which contains such potential dangers. We cannot expect to convert a boom that is based upon fear and loss of confidence in our monetary system into a sound and lasting prosperity.

As I pointed out in my recent statement before the Silver Committee, I advocate as the most effective means of achieving our common objective a broad Government program of expenditures for non-competitive projects and social benefits along with every possible encouragement to private investment. Revival of private investment, which is essential for sustained recovery, depends upon an increase in current consumption to a level that will not only utilize existing plant and equipment but will provide profitable outlets for investment in new enterprise.

You imply in your letter that other countries have been able to accomplish by monetary policies that which the Board's statement denies can be accomplished. This view, which has often been stated, does not seem to be supported by the facts:

(1) Monetary authorities of no country have taken as vigorous action to increase the supply and reduce the cost of money as have the authorities in the United States. (2) Differences in behavior of prices in this country and in England and Sweden, the two countries most frequently cited as examples of advanced monetary policy, have not been striking. (3) Such variations in economic developments as have occurred in the different countries are attributable to other factors than monetary policies. (4) Monetary authorities of other countries themselves do not believe that monetary action alone can create and maintain any desired price level. I am informed that in Sweden the objectives of the Riksbank's policy are substantially those enunciated in the statement issued by the Board of Governors of the Federal Reserve System in August 1937.

Neither in England nor Sweden has central bank policy made money easier than it is in the United States. The Swedish Riksbank has disbursed comparatively little through purchases of securities since 1929; its discounts and advances have been sharply reduced; and its rediscount rate has been lowered to only 2 per cent as against 1 and 1 1/2 per cent for our Federal Reserve banks. The cash reserves of the Swedish commercial banks, which are the basis of the deposit currency of the country, have been greatly increased by the inflow of funds from abroad, as have reserves in the United States; but the rates charged by the leading commercial banks on loans are no lower than those charged by leading banks in the United States.

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The Bank of England has pursued a far less expansionist policy than that of the Federal Reserve banks. It has done little to expand commercial bank reserves through security operations. From time to time it has disbursed funds through the purchase of large amounts of gold, but the gold acquisitions of the British Exchange Equalization Account have been sterilized and prevented from increasing the amount of money available to the public, in sharp contrast to the way that the gold inflow has been handled in this country. In England the growth in the demand for currency and the needs of the banks for additional reserves against deposits have been met; but the supply of money has not been increased, as it has been here, to the point where the public and the banks have large amounts of unused funds. Both the discount rate of the Bank of England and market rates of interest remain higher in England than the corresponding rates in the United States. The Bank of England's discount rate is 2 per cent as compared with 1 per cent at the Federal Reserve Bank of New York, and the prevailing rate for industrial and commercial loans is around 4 1/2 per cent in England compared with an average of about 3 per cent for banks in leading cities in the United States.

The experience of the United States since 1932 so far as wholesale prices is concerned has not differed much from that of England and Sweden. Earlier in the depression prices fell further in the United States. Differences between developments in this country and those in England and Sweden, however, are not attributable to more stimulative policies pursued by the central banks of these countries, since their policies have in fact been less stimulative. The differences are the consequences of broadly differing economic situations. A comparison of price movements in the three countries is shown below:

WHOLESALE PRICE INDICES

(1929 = 100)

	United States	United Kingdom	Sweden
1932	68	75	78
1937	91	95	98
1938	83	89	93

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I should also like to explain the differences between the amount of demand deposits as shown in the Board's statement and in your letter. The differences arise in part from the exclusion from your figures of deposits of State and local governments which have increased by about $1,000,000,000 since 1929. Since these deposits are generally used as actively as deposits of individuals and corporations they are included in our total of demand deposits. Another difference is that the Board's figure is adjusted to exclude the amount of cash items held by banks in process of collection, which represent checks drawn on deposits but not yet debited and, therefore, funds not available for further use. These deductions were about $700,000,000 larger in June 1929, when deposits were active, than in December 193[illegible]. The principal difference, however, arises from the fact that your figure for 193[illegible] refers to the end of June while the Board's figure refers to the end of December. In the six months from June to December 193[illegible] there was an increase of $1,600,000,000 in demand deposits at banks. Whatever figures are used, however, it is clear that the amount of deposits was larger in 193[illegible] than in 1929, while prices were 20 per cent lower.

Very truly yours,

M. S. Eccles,
Chairman.

Enclosure
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M.F.

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