ECONOMISTS' NATIONAL COMMITTEE ON MONETARY POLICY
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Monetary Notes

By WALTER E. SPAHR

February 29, 1944

1. Time for some red flags. -- When our Federal Reserve credit structure reached the cracking point in May, 1920, the ratio of reserves against both Federal Reserve notes and deposits in the Federal Reserve banks stood at 42.2 (May 14). Eight of the Reserve banks paid tax penalties for deficiencies in reserves in that year.

   On February 23, 1944, the reserve ratio stood at 62.4. If the decline continues for another sixteen months -- to June, 1945 -- at the same rate as in the past sixteen months, we will be down to the 42 per cent of May, 1920. Sixteen months ago -- on October 21, 1942 -- the reserve ratio stood at 83.1.

   If the downward trend in this reserve ratio continues at anything like the rate of the past sixteen months, all the talk and agitation regarding the putting of several billions of dollars of our gold at the disposal of other countries will become academic indeed, unless members of Congress fail to notice the danger signals in these declining reserve ratios and lead this country into a program that can quickly become extremely dangerous, and possibly disastrous.

   If, today, five billion dollars of our gold were set aside for one or all of the international banking programs, and not counted as part of the reserves of the Federal Reserve banks, our reserve ratio would stand at approximately 47 per cent -- not far above the cracking point of 1920.

   What economist can demonstrate in any convincing manner that the trend between now and June, 1945, will not be as sharply downward as it has been since October, 1942?

   Recent experience calls for great prudence now. From here on we should regard the declining reserve ratios as red flags of warning.

   Let every thoughtful person consider what the situation will be if, by June, 1945, our reserve ratio reaches 42 per cent! What if government bonds crack as they did in 1920? A drop of ten points in the prices of government bonds would wipe out the capital, surplus, and undivided profits of many, perhaps most, of the large banks of this country. A radical devaluation of the dollar would probably follow. A financial collapse and chaos could well be the result.

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Sixteen months are not a long time; and it looks as though they are going to be a vital sixteen months in the financial affairs of this nation.

2. The matter of Treasury domination in financial affairs. -- There is another aspect in this financial picture that calls for serious consideration: that is the important part played by the Treasury in the foreign exchange and domestic money markets and in the operations of the Federal Reserve System.

   In general, these Treasury policies involve artificialities of a sort that promise to be unhealthy in the long run; and the unhealthiness of some of them has been apparent for too long a time.

   Foreign exchange rates are chiefly in the hands of the Treasury, operating through the Stabilization Fund. The British pound is pegged at what is doubtless an artificially high rate which means that we are subsidizing Britain in this respect.

   The artificially low interest rates maintained by the Treasury have operated to remove from the Reserve authorities the power to exercise effective control over credit in the money markets in which the Reserve authorities normally would exercise controls. Furthermore, these low money rates will make it inviting for foreign balances to move out at the first opportunity, and these movements may take the form of gold exports. In addition, our gold will tend to move out for a multitude of other purposes because of this same pressure.

   Most of these pressures are operating in the direction of a further and perhaps unexpectedly sharp decline in the reserve ratios in the Federal Reserve banks. The edging of the Federal Reserve banks, by the Treasury, out of proper performance of their functions is fundamentally an unsound piece of business. In the end, the American people appparently will have to learn this lesson the hard way. The Reserve banks should be in a position to exercise their normal controls, with very few war-time exceptions. Treasury domination and control and interference should be reduced and finally eliminated as rapidly as possible.

   If Treasury control and artificially low interest rates continue much longer, with the Reserve authorities merely the puppets of Treasury policy, we are headed for serious trouble.

   This picture, combined with the consideration of plans to have the Treasury contribute millions and billions of dollars to this program and that for international rehabilitation, currency stabilization, and so on, should suggest the wisdom of pulling up sharply and taking a good look at this trend of programs and policies.

3. Watering or diluting the reserves of Federal Reserve banks. -- Another matter to which Congress has persistently shut its eyes is the diluting of the reserves of the Federal Reserve System. This is another instance of too much United States Treasury influence in the monetary picture -- permitted or forced by Congress. As an example of the latter, overvalued silver certificates have been going into the reserve structure rather steadily under pressure of the silver subsidy policy.

   Perhaps the most important case of bad practice permitted by Congress is the injection of $660,000,000 of fiat paper money into the reserves of the Federal Reserve System by the manipulation of these notes by the Treasury and Reserve authorities, beginning December 12, 1942.

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By that juggling, sleight-of-hand, "retirement" before issuance transaction, the Federal Reserve bank notes (National Currency notes) were made assets (lawful reserves) of these banks, and in the form of fiat money at that, whereas under the law these notes are supposed to be Reserve bank liabilities while they are being issued. While the Treasury and Reserve authorities gave the Reserve banks $660,000,000 of fiat money for reserves -- an illegal transaction on every count --, the Treasury, by this same transaction, handed itself a deposit credit in the Federal Reserve banks to the extent of $660,000,000 -- also an illegal transaction on every count.

Watering down the reserves of the Federal Reserve banks with fiat money is a bad piece of business at any time; but it is doubly bad when the reserve ratio is falling rapidly and when reserves need to be good -- not watered milk!

The investigation made by a few members of Congress of this Federal Reserve bank note affair in January and February, 1943, was not competent. The Congressmen were overwhelmed with technicalities thrown at them by the Reserve and Treasury officials and effectively bluffed out of the picture.

Let any Congressman take the Federal Reserve Bulletin for January, 1944, consult the table "Kinds of Money in Circulation" (p. 67), look at the column on Federal Reserve bank notes, and see how the volume of these notes in circulation has increased every month, beginning December, 1942. (The February, 1944, Bulletin, because of the changes in tables, is not so useful since it obscures the facts.) Then let him look at "Treasury currency" on the same page and he will see that these notes are Treasury liabilities -- not liabilities of the Reserve banks as they are legally supposed to be while being issued. Then the Congressman should look at the last line of the footnote at the bottom of the page: There he will find it said that "Federal Reserve Bank notes and national bank notes are in process of retirement." In short, the table will show him that the Federal Reserve bank notes in circulation are steadily increasing while the footnote says they are "in process of retirement." Then the Congressman should ponder that!

This conflict of assertion with fact grew out of the Reserve officials' contention, while being investigated in January-February, 1943, that they "retired" these notes before they were issued by the Treasury!

Next, if he thinks it proper for the Treasury to issue these notes, let him read the Federal Reserve Act.

Finally, if the Congressman thinks these notes are not fiat money, let him look at the admission of the then Acting Secretary of the Treasury, Daniel Bell, who conceded, under questioning by Representative Frank Keefe of Wisconsin, at hearings before the Subcommittee of the House Committee on Appropriations, January 18, 1943, that they are precisely that -- just like unsecured United States notes.

With these facts and admission available, Congress still let the Treasury and Reserve authorities get away with this manipulation -- perhaps the worst one that has ever marred the monetary history of this country.

It is a fine illustration of what administrative agencies can do right under the nose of Congress if there are sufficient technicalities thrown up to distract and confuse the busy Congressman.

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This matter should be reopened and the facts explored thoroughly.

4. The "Inflationary Gap" nonsense still continues. -- Perhaps few currently-popular statistical calculations equal in sheer nonsense and in muddle-headed thinking those which purport to show the "inflation gap" from time to time. The Commercial and Financial Chronicle for February 10, p. 619, carries a typical example in the calculation submitted by Dr. George C. Haas, Director of the Treasury's Division of Research and Statistics, to the House Appropriations Committee on February 4.

   Much of the confused thinking involved in the Haas example lies in the apparent failure to understand that income and expenditures, individual and national, are a stream -- a flow -- and in the fact that net income, which is a spot check at a particular time, results from this flow.

   Net income for any period does not indicate what the flow for any succeeding period will be, nor does the flow of expenditures for any period indicate what the net income of that period will be. For example, one man may receive $50,000 and spend $50,000 in a year and have no net income at the end, but the known flow at this point is $100,000 -- $50,000 from someone to him, and $50,000 from him to someone else. Another person may receive $25,000, spend $10,000 for consumers' goods, have a net income of $15,000 of which he invests $10,000, which goes back into the flow, and of which $5,000 is left by him in a bank which may put it in circulation for him. Then he may borrow $10,000 at the bank and put that in circulation too, but it will not represent income for him, although it will for the recipient.

   National income, properly conceived, is merely the net income of all the people in the aggregate for some specified period. But income is in fact a flow, and, when calculated for a given period, the interpretation of its meaning requires care -- more care than the "inflation gap" calculators have thus far shown.

   Haas says "we estimate income payments for the fiscal year 1944 at $148,000,000,000."

   What does this figure mean? All money spent is also income for others. In 1943, bank debits alone for banks in 334 reporting centers amounted to $792,937,000,000. What is the relation of Haas' income payments to debits or to total expenditures? If he thinks he has net income figures, what is the relation of such a calculated net income to the total expenditures of which even debits to bank deposits are not all?

   It should be said with some emphasis that people's net incomes for any specified period do not determine total expenditures or prices for that period or for a succeeding one. It is all expenditures, in the form of a flow, against all goods and services, in the form of a flow, that determine prices!

   Why anyone should relate net income figures for a year -- even if they were known, and they are not -- to an estimated supply of goods and services, supposed to be available in the following year, and then assume that he can get such a thing as an "inflation gap" out of such an unrelated set of figures is a mystery -- or at least it should be.

   Such a person cannot possibly know how many goods will be produced and available in the succeeding year, or the rate at which they will come on to the market, or the rate at which they will be bought, or what services will be bought, or what the prices of these goods or services will be, or how many times goods will turn over

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in trade, or how people will use their purchasing power. And he surely should be able to see that the purchasing power of that year is not determined by the estimated national income of the preceding year. A huge volume of business each year is done on credit. Certainly the estimated national income for 1942 did not constitute more than a small portion of bank debits for 1943, and it was but a fraction of the amount spent for non-war goods and services.

Furthermore, why are estimates of national income for a year used in computing the "inflation gap"? Why is it not just as reasonable to use estimates of average monthly net income? Does not average monthly income have as much to do with one's expenditures as does the yearly total? How would the mystic "inflation gap" be calculated if national income for an average month were used? And why is borrowing ignored? Why is the ability of people to utilize past savings overlooked?

Haas goes on: "We estimate that individuals will pay direct taxes to both Federal, State and local governments of $22,000,000,000. That leaves $126,000,000,000 [out of the $148,000,000,000] which we call disposable income which people will have to spend on goods and services, if they so choose."

If $22,000,000,000 is paid in taxes, will not other people receive it in payments made by the government? Haas seems to assume that it will stay in the Treasury for a year!

Several New Dealers have insisted that the best way to get money into circulation quickly is for the government to tax the people and do the spending itself. These New Deal spenders and Inflation Gapists should get together on these little inconsistencies!

Haas then goes on to say that the people will have $126,000,000,000 left after taxes with which to buy $90,000,000,000 of goods and services, and $90,000,000,000 from $126,000,000,000 gives him an "inflation gap" of $36,000,000,000!

If bank debits for 1944 should equal the $792,937,000,000 debits for 1943, one may wonder what Mr. Haas thinks the difference between his $90,000,000,000 and the $792,937,000,000 means! Were not all the checks in bank debits of 1943 used to buy goods and services during that year?

Just what does Mr. Haas' $90,000,000,000 refer to anyway? The answer is that it represents fantastic nonsense -- it is just $702,937,000,000 less than the goods and services bought by checks alone in 334 cities in 1943! If half of national expenditures in 1944 should be for war goods and services, Mr. Haas' $90,000,000,000 is still absurd in the face of the remaining half, if debits for 1944 should equal those for 1943.

Mr. Haas and others who have been engaging in this sort of mystic calculation might do well to study the meaning of bank debits, of the velocity of currency, of the movements of goods, services, and purchasing power through the various channels of trade, and then consider the lack of relation of national income estimates to these data which certainly are the ones that determine prices.

5. Celler silver-purchase amendment voted down. -- On February 9, Representative Emanuel Celler of Brooklyn introduced an amendment to the Treasury and Post Office Department Appropriation Bill, 1944, in which he proposed the following:

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"No part of any money appropriated by this act shall be used directly or indirectly during the fiscal year 1945 for the purchase or procurement of silver under the provisions of the Silver Purchase Act of June 19, 1934, and the act of July 6, 1939, or for the purpose of carrying out any of the provisions of said Silver Purchase Acts."

This amendment was identical with the one he offered to the Treasury Department appropriation bill last year, and which carried by a voice and teller vote in the House, only to be stricken out by the conferees.

The House, acting as a Committee of the Whole, rather promptly (on February 9) voted down this proposed amendment by a vote of 50 to 22. (See Congressional Record, February 9, 1944, pp. 1489-1500.)

Representative Celler certainly deserves the warm applause of the general public for his fight to rid the country of these silver-subsidy laws. Furthermore, his efforts, had they been successful, would have removed the Secretary of the Treasury from the embarrassing position in which he finds himself through no fault of his own.

Under the Silver Purchase Act of 1934, he is supposed to continue to purchase silver until the dollar-value of the silver monetary supply equals one-fourth the dollar-value of the stock of monetary gold and silver, or until the price of silver reaches $1.2929 per fine ounce. On the other hand, the Secretary has recognized the need for silver by war industries, and has taken steps to see to it that the silver which he is supposed to buy goes into these industries. He is, in short, forced to violate the Silver Purchase Act of 1934 if he is to do the proper things to help to win this war.

Congress often criticizes administrative officers for violation of law and yet, in this case, Congress literally forces the Secretary to violate this silver purchase law, since one can easily imagine how the American people would be aroused if he did not do what he is doing to put silver at the disposal of war industries. And Congress keeps the Secretary in this awkward position for no other reason than to appease the silver-bloc. All along, Secretary Morgenthau has been far ahead of Congress in the soundness of his position with respect to this silver subsidy business. More than once he has said that he would like to see all these silver laws stricken from the statute books. In a similar way, Representative Celler has been far in advance of the majority of Congress in his attempts to end this disgraceful piece of business. The record of Congress in this matter is a national disgrace.

6. Silver security against silver certificates. -- So far as this office has been able to ascertain from official sources, none of the silver behind silver certificates has yet assumed the form of silver loaned for industrial uses, as unwisely authorized in the Green silver law of July 12, 1943.

7. Treasury moves to immobilize gold looted by Axis countries. -- On February 22 the Treasury issued the following announcement:

". . . The United States Government formally declares that it does not and will not recognize the transference of title to the looted gold which the Axis at any time holds or has disposed of in world markets. It further declares that

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it will be the policy of the United States Treasury not to buy any gold presently located outside of the territorial limits of the United States from any country which has not broken relations with the Axis, or from any country which after the date of this announcement acquires gold from any country which has not broken relations with the Axis, unless and until the United States Treasury is fully satisfied that such gold is not gold which was acquired directly or indirectly from the Axis powers or is not gold which any such country has been or is enabled to release as a result of the acquisition of gold directly or indirectly from the Axis powers."

The Treasury announcement says further:

"It is understood that a similar Declaration is being issued simultaneously by the United Kingdom Treasury, and by the Union of Soviet Socialist Republics."

8. How the Nazis strip The Netherlands. -- The Netherlands Information Bureau (5 Dupont Circle, N.W., Washington 6, D. C.) in a release of February 13 said:

"The Nazis have imposed on the Netherlands treasury the huge burden of $1,684 millions against alleged 'occupation costs.' In addition they forced Dutch exports to Germany and made the Netherlands Bank finance these exports after the termination of the clearing system between Holland and Germany on April 1, 1941. Thus from that date the accounts of the Bank show a claim on Germany which had reached about $1.5 billions in September, 1943.

"By these means, which on the surface bore a legal character, the Nazis succeeded in stripping the country of all available goods and leaving it with worthless claims. By the same practices they confiscated Jewish property valued at $300 millions."

9. Condliffe on "Money and International Trade." -- This is the title of pamphlet No. 10 in the Bratter Monetary Standards Inquiry series (408 Graybar Building, New York 17, N. Y.). Condliffe believes that the time has passed when one precious metal or a combination of them can be relied upon as a monetary standard. He advocates an international money of account. John B. Condliffe is Associate Director, Division of Economics and History, Carnegie Endowment for International Peace. This year he is research professor at Yale University, on leave from the University of California.

10. Crider on "It's Your Money, Brother!" -- That is the title of a well-written and interesting article by John H. Crider, Washington newspaperman, in The Saturday Evening Post for February 26. He has no illusions, apparently, about the Keynes, Alvin Hansen, and Stuart Chase theories.

11. Mitchell and global bimetallism. -- Professor Humfrey Mitchell, Professor of Political Economy at McMaster University, Hamilton, Ont., has published a pamphlet, No. 11, The Place of Silver in Monetary Reconstruction, in the Bratter Monetary Standards Inquiry series (408 Graybar Building, New York 17, N. Y.) in which he advocates global bimetallism. According to the news release, Mitchell says that "It has never been questioned that an international bimetallic system will work. Nothing whatever stands in its way and its success is assured."

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If Mitchell thinks the workability of an international bimetallic system has never been questioned, one may wonder what he has read on the subject. Even some of the pamphlets which preceded his in this series questioned it. If the quotation is a fair sample of the scientific writing in the Mitchell pamphlet, then the international bimetallists have not had much help in their attempts to advance the cause of international bimetallism and of those who wish to do something more for silver.

12. Sullivan on bureaucracy. -- Lawrence Sullivan, a Washington journalist, has published a book, Bureaucracy Runs Amuck (Bobbs-Merrill Co., 468 Fourth Avenue, New York), 287 pages.

13. Cable becomes President. -- Dr. J. Ray Cable, formerly Associate Professor of Finance and Banking at Washington University, St. Louis, and a member of this Committee, has become President of Missouri Valley College, Marshall, Mo. Our best wishes to the new President!

14. Lohman elected to Committee. -- Dr. Philipp H. Lohman, on leave from Miami University, Oxford, Ohio, as Associate Professor of Economics, and at present a contributing editor of Time magazine, has been elected to membership in the Economists' National Committee on Monetary Policy. For the current semester, he is also doing some teaching on a part-time basis in the Department of Economics, School of Commerce, Accounts and Finance, New York University. The Commercial and Financial Chronicle of February 24 carries an article by Dr. Lohman on "NASD 5% Rule Threat To Post-War Employment and Small Business."

15. Palyi on "Will Deposits Decline?" -- This is the title of an article by Dr. Melchior Palyi in The Commercial and Financial Chronicle for February 3.

16. Wright on "The Money Problem in Planning a Post-War Economy." -- This is the title of an article by Dr. Ivan Wright of Brooklyn College in The Commercial and Financial Chronicle of February 24. Copies may be obtained from the office of the Chronicle (25 Spruce Street, New York 7, N. Y.) or from this office.

17. This office has just received notice that the new address of Dr. E. C. Harwood, a member of this Committee, is Col. E. C. Harwood, C.E., 012615, A.P.O. No. 9744, c/o Postmaster, San Francisco, California.

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