Mr. Thomas -

ROBERT A. TAFT
OHIO

COMMITTEES:
LABOR AND PUBLIC WELFARE, CHAIRMAN
FINANCE

I. JACK MARTIN
SECRETARY

United States Senate

WASHINGTON, D. C.

November 28, 1947

Honorable Marriner S. Eccles,
Chairman, Board of Governors,
Federal Reserve System,
Washington, D. C.

Dear Marriner:

I wish to say how much impressed I was with the careful presentation you made before our Committee. Certainly, I shall give every possible consideration to your forthright recommendations.

May I inquire about two other matters which were not covered? A suggestion has been made that we sterilize gold which is coming into the country. We had two billion dollars of this gold sterilized in the stabilization fund which was turned loose on the world through the International Fund. Would it not be helpful in preventing inflation to build up again a fund of perhaps two billion dollars to replace what we had? Is this practicable?

I have received several complaints from the Stock Exchange people regarding a 75% margin on stocks as compared to other property. It is claimed that this prevents the sale of stocks and so leads to the financing through borrowing which is more inflationary. I should be glad to have your views on that point.

With best wishes,

Sincerely yours,

Robert A. Taft

RT:o

11/25/47
Testimony file

December 5, 1947.

Dear Bob:

I very much appreciate your comment on my presentation before your committee, and I am glad to have an opportunity to answer the two questions in your letter of November 28.

I do not think it would be practicable to build up again a fund, say, of 2 billion dollars to replace what was taken from the so-called stabilization fund. That fund, as you will recall, was created out of thin air; that is, it was derived from marking up the price of gold to $35.00 an ounce. This fund was not used to sterilize gold.

Beginning at the end of 1936 the Treasury for the better part of the next two years sterilized gold by selling enough Government securities to the banks, which then had large amounts of excess reserves, to offset the gold purchased by the Treasury and held in an inactive account. In effect, the additional reserves created by the gold inflow were absorbed by the Government securities which, as I recall, were chiefly Treasury bills.

The situation now is very different. The banks do not have excess reserves and the Treasury, as you know, is paying off bank-held public debt out of its cash surplus. To the extent that this budgetary surplus was used instead to sterilize gold there would be that much less available to retire Government debt held by the banks, which is just as effective an anti-inflationary measure as sterilizing gold. And as debt is paid off interest costs to the Government are thereby reduced. The most practical way, in my opinion, to get at the problem is through the Board's proposal for a special reserve requirement which could be gradually increased to absorb future gold acquisitions, leaving the entire budgetary surplus available to pay off debt.

With regard to your other question about the 75 per cent margin on stocks, the Board has heard a good deal about this from Emil Schram. It is, of course, a stiff margin requirement. The stock market, however, is one sector of the economy which will not have to go through the wringer if we have a deflation. The market is not inflated on borrowed dollars as it was in the late 20's. I think that is very salutary, though of course I can quite understand the contrary feeling of brokers who are interested in volume, from which they derive commissions, and of speculators whose wings are clipped when they cannot borrow more for their operations. Our margin requirements do not prohibit borrowing on listed stocks for any purpose except for buying more listed stocks.

In a recent letter to me, Mr. Schram contended that the 75 per cent margin was discouraging equity issues for necessary production and was driving business to borrow from the banks instead of from investors. His argument in effect was that the production was needed to combat the inflation and that borrowing from banks is per se inflationary. The trouble with his line of reasoning is that, in the first place, it overlooks the acute scarcities of labor and materials. Any further borrowing of funds at this time, whether from investors or from banks, would lead to intensified competition for scarce labor and materials and would manifestly serve only to drive prices up still higher.

It overlooks further the fact, however, that if the margins were reduced to 50 per cent, as he advocates, it would be equivalent to an open invitation to the general public to use additional bank credit in order to participate in equity financing. To the extent that bank credit would thus be expanded the effect would be even more inflationary than direct loans to business by banks, because a lot of it would be used for other purposes and only a small part would reach business through increased equity financing. Unquestionably there are times when equity financing and expansion of credit to call forth new production would be in the public interest. Unfortunately, this doesn't happen to be one of those times.

From considerable inquiry into the subject I have concluded that business in most instances at least would be more likely to borrow from the banks even if the margins were reduced than to go through the process of floating equity securities. For one thing, the flotation of more stocks dilutes and changes the proportion of stock holdings. For another -- and I think this is important -- business can deduct interest charges under the corporate tax laws. Then, too, interest rates on business loans by the banks have been at exceptionally low levels.

I could elaborate further on these two matters, but possibly this will suffice to answer what you have in mind. If not, I certainly hope you will let me know. Let me also reciprocate your best wishes.

Sincerely yours,

The Honorable Robert A. Taft,
United States Senate,
Washington, D. C.

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