[illegible]

(not sent)

W.R.G.
July 2, 1942

Mr. H. B. Elliston,
Associate Editor,
The Washington Post,
Washington, D. C.

Dear Mr. Elliston:

I have your letter of June 23 enclosing a clipping of a letter from Congressman White published in the Washington Post. I regret that neither in the Bulletin nor in testimony have we dealt ~~directly~~ specifically with Mr. White's contention that silver money is costless while Federal Reserve notes impose an interest charge on the public. The contention is in some respects related to Mr. Patman's argument that the Government should finance its expenditures by issuing new money instead of paying interest to the banks, and I am, therefore, enclosing as of possible interest to you a copy of a letter which I wrote to Mr. Patman ~~on~~ [illegible] March ~~31,~~ 1941. Mr. Spahr of the Economists' National Committee on Monetary Policy has already engaged in correspondence with Mr. White on the question of silver money vs. Federal Reserve notes and you may wish to consult this correspondence in the Congressional Record: April 30, 1942 (page 3978); June 8, 1942 (page 5209); June 9, 1942 (page 5230). In the Wall Street Journal of June 30 there was published a vigorous rejoinder to Mr. White written by Delmer Hubbell.

The facts of the case appear to be reasonably simple. Anyone who has a deposit with the Federal Reserve Banks may draw upon it to obtain Federal Reserve notes. No interest is charged on this transaction. The deposit may, it is true, be the result indebtedness. Corporate security issues for new capital, however, which are of greater significance in connection with expansion of durable goods industries, were in larger volume in the first half of 1937 than in the similar period of any other recent year.

Anticipating autumn demands

In view of increasing indications of uncertainty in business prospects, the Board in midsummer reexamined the banking situation with particular reference to the reserve position of member banks, for the purpose of determining whether there was any action which the Federal Reserve authorities could undertake to counteract possible unfavorable business developments. This review showed that the volume of funds for purposes of lending and investment was adequate in all classes of banks; that there was a continued increase in the banks' lending for business purposes, and that liquidation by banks of their Government securities had practically ceased.

In anticipation of possible seasonal demands for credit and currency in the autumn, the Federal Reserve banks in August and September reduced their discount rates. After these changes were made the rate at the Federal Reserve Bank of New York stood at 1 percent, the lowest central bank rate in history, and at the other Federal Reserve banks at 1 1/2 percent. By placing Reserve bank discount rates at a level in closer relationship to rates in the money market, the Federal Reserve System made it possible for individual member banks to meet seasonal or exceptional demands by borrowing from the Federal Reserve banks, rather than by liquidating any of their assets. The Board also issued in September a revision of its Regulation governing discounts for and advances to member banks, carrying out changes in the law made by the Banking Act of 1935, and explaining the rules under which member banks can obtain accommodation at the Federal Reserve banks on advances secured by any sound asset.

of direct borrowing from the Federal Reserve Banks or the sale of Government securities to them, in which case interest is involved; but the deposit may also be the result of the transfer ~~deposit~~ of gold or silver certificates to ~~in~~ the Federal Reserve Banks or other cash transactions. Currently the Federal Reserve Banks have outstanding 9 billion dollars of notes and 14 billion dollars of deposits, only 2-1/2 billion dollars of which have resulted from operations involving interest.

While it is true that a portion of Federal Reserve notes outstanding may have their ultimate source in operations involving interest, this does not mean that even this portion costs the public more than silver certificates. Silver certificates are not given to the public. The Treasury deposits them, together with other funds, in the Federal Reserve Banks and checks against the deposit to purchase goods and services from the public or to make loans. In the former case the public exchanges its goods and services for the Treasury's funds created by the issue of silver certificates; in the latter case the public borrows these funds and pays interest just as in the case of the Federal Reserve notes. In neither case does the public get the money without giving a quid pro quo.

It is obvious that from a national standpoint silver money is more costly to issue than Federal Reserve notes since ~~i.e.,~~ silver is more costly than paper. The silver certificate does not perform the function of money any more effectively than Federal Reserve notes; hence the additional cost of issuing it is a national waste. If it were advisable for the Treasury to finance itself by issuing conditions in the Government security market for a period in March were disorganized, and the average yield on long-term Government bonds rose from little over 2 1/4 percent in February to 2 3/4 percent early in April. Yields on high-grade corporate bonds also advanced.

In order to stabilize conditions in the money markets the Federal Open Market Committee engaged in a series of open-market operations. Between March 10 and March 31 it increased the System's holdings of Treasury bonds by $104,000,000 and at the same time reduced its holdings of Treasury notes by $85,000,000 and its holdings of Treasury bills by $19,000,000, so that the total of its portfolio of Government securities remained unchanged. On April 4 the Federal Open Market Committee issued the following statement:

"With a view (1) to exerting its influence toward orderly conditions in the money market and (2) to facilitating the orderly adjustment of member banks to the increased reserve requirements effective May 1, 1937, the Open Market Committee of the Federal Reserve System is prepared to make open-market purchases of United States Government securities for the account of the Federal Reserve banks in such amounts and at such times as may be desirable. This purpose is in conformity with the policy announced by the Board of Governors of the Federal Reserve System in its statement on January 31, 1937, which declared, with reference to the increase in reserve requirements, that by this action the System would be placed in a position where such reduction or expansion of member bank reserves as may be deemed in the public interest may be effected through open-market operations."

Between April 4 and April 28 the System purchased $96,000,000 of Treasury bonds, increasing its account by this amount. Government and other high-grade bond prices stopped declining in the early part of April. For the remainder of new money instead of taxing or borrowing the resources necessary to cover its expenditures, it would be cheaper, and equally effective, to issue greenbacks rather than to acquire silver and issue silver certificates. But as is indicated more at length in my enclosed letter to Mr. Patman, I do not believe it advisable for the Treasury to finance itself by either greenbacks or silver certificate issues.

Sincerely yours,

Chairman.

Enclosure

Board's power under the law to increase reserve requirements. The Board stated that it was not its intention to request from Congress additional authority to absorb excess reserves by means of further raising reserve requirements.

In order to give the banks ample opportunity to adjust to the new requirements, the Board in announcing the increase on January 31 provided that one-half of it would take effect on March 1 and the other half on May 1.

Adjustment to increased requirements

Following the announcement of the increase in reserve requirements on January 31 short-term money rates and yields on Government and high-grade corporate bonds advanced somewhat. In preceding weeks some of these rates had increased slightly from the extraordinarily low levels reached near the end of 1936. These advances were taken by many investors, including banks, as an indication that the long continued decline in bond yields had come to an end. As a consequence, there was a tendency to liquidate bonds in order to realize accrued profits. Banks in New York City had begun to sell Government securities as early as the middle of 1936 following an extremely rapid expansion of their Government portfolio in the first half of that year. These sales continued in the early months of 1937.

Early in March, in order to meet the increase in reserve requirements and withdrawals of balances held for interior banks, a few of the large money-market banks increased their sales of Government securities. The securities sold were principally long-term bonds, on which they had profits, rather than short-term notes and bills, which they held in substantial volume. This selling movement spread to other banks and to other holders of bonds, which at first also wanted to realize their profits and later, as prices declined, to avoid losses. As the result of this selling movement, which assumed large proportions,