AMENDING SECTIONS 16 AND 18 OF THE FEDERAL RESERVE ACT

HEARING

BEFORE THE

COMMITTEE ON BANKING AND CURRENCY UNITED STATES SENATE

SEVENTY-EIGHTH CONGRESS

FIRST SESSION

ON

S. 658

A BILL TO REPEAL THE SIXTH PARAGRAPH OF SECTION 18 OF THE FEDERAL RESERVE ACT

AND

S. 1041

A BILL TO EXTEND THE PERIOD DURING WHICH DIRECT OBLIGATIONS OF THE UNITED STATES MAY BE USED AS COLLATERAL SECURITY FOR FEDERAL RESERVE NOTES

MAY 4, 1943

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AMENDING SECTIONS 16 AND 18 OF THE FEDERAL RESERVE ACT

TUESDAY, MAY 4, 1943

UNITED STATES SENATE,
COMMITTEE ON BANKING AND CURRENCY,
Washington, D. C.

The committee met at 10:30 a. m., pursuant to call, in room 301 Senate Office Building, Senator Robert F. Wagner, chairman, presiding.

Present: Senators Wagner (chairman), Maloney, Radcliffe, Clark of Idaho, Murdock, Scrugham, Tobey, Danaher, Taft, Thomas of Idaho, Butler, and Buck.

The CHAIRMAN. The committee will please come to order. Mr. Eccles, we are delighted to see you.

Mr. ECCLES. I am glad to be here, Senator Wagner.

The CHAIRMAN. We are considering S. 1041 and would be glad to have you make a brief explanation of it, although I think the members of the committee understand it pretty well.

We are also considering S. 658, a bill introduced by Senator Taft.

(The bills, S. 1041 and S. 658, are as follows:)

[S. 1041, 78th Cong., 1st sess.]

A BILL To extend the period during which direct obligations of the United States may be used as collateral security for Federal Reserve notes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the second paragraph of section 16 of the Federal Reserve Act, as amended, is hereby amended by striking therefrom the words "until June 30, 1943" and by inserting in lieu thereof the words "until June 30, 1945."

[S. 658, 78th Cong., 1st sess.]

A BILL To repeal the sixth paragraph of section 18 of the Federal Reserve Act

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the sixth paragraph of section 18 of the Federal Reserve Act, as amended by section 401 of the Act approved March 9, 1933, is hereby repealed.

SEC. 2. All Federal Reserve bank notes issued under the authority of section 18 of the Federal Reserve Act, received by any national bank or by any Federal Reserve bank, shall be promptly presented to the Treasury for payment, and upon payment shall be retired.

The CHAIRMAN. You may proceed, Mr. Eccles.

STATEMENT OF MARRINER S. ECCLES, CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, WASHINGTON, D. C.

Mr. ECCLES. I think, possibly, the shortest explanation I could possibly make of S. 1041 would be to read the letter I sent to you.

The CHAIRMAN. You might put it in the record.

Mr. ECCLES. If you have no objection, I will read it as it briefly sets forth the situation.

The CHAIRMAN. We will be glad to have you proceed in your own way.

Mr. ECCLES. I wrote you on April 26, 1943, as follows:

The Board of Governors of the Federal Reserve System respectfully recommends that the temporary authority contained in the second paragraph of section 16 of the Federal Reserve Act to use direct obligations of the United States as collateral security for Federal Reserve notes be extended for an additional period of 2 years, expiring on June 30, 1945. For the consideration of your committee, there is enclosed a draft of a bill which would accomplish this purpose.

Section 16 of the Federal Reserve Act was amended by the act of February 27, 1932, so as to provide that until March 3, 1933, the Board, if it deemed it in the public interest, should have authority, by the affirmative vote of not less than a majority of its members, to authorize the Federal Reserve banks to offer and the Federal Reserve agents to accept direct obligations of the United States as collateral security for Federal Reserve notes. This authority was extended for temporary periods by the acts of February 3, 1933, March 6, 1934, March 1, 1937, June 30, 1939, and June 30, 1941.

The CHAIRMAN. Is it not a fact that Senator Glass was the introducer of that bill?

Mr. ECCLES. This was known as the Glass-Steagall bill. It was enacted in 1932, and the time limit has been extended on all the dates I have enumerated.

The CHAIRMAN. Very well. You may continue.

Mr. ECCLES. I continue reading:

Unless renewed this authority will expire on June 30, 1943.

During the early years covered by these amendments direct obligations of the United States were pledged as collateral for Federal Reserve notes until the amount of gold certificates held by the Federal Reserve banks and due from the United States Treasury increased to such an extent that it became unnecessary to continue the use of direct obligations of the United States as collateral. From May 28, 1938, until recently the amount of such gold certificates was so greatly in excess of the amount of Federal Reserve notes in circulation that the Federal Reserve banks were able to pledge gold certificates with the Federal Reserve agents as collateral security for all Federal Reserve notes issued to them, without in any way impairing their reserves against deposits. However, as the result of a steady increase of money in circulation during the past 2 years, it has become necessary for the Federal Reserve banks to pledge Government securities with the Federal Reserve agents as collateral for Federal Reserve notes. Furthermore, the demand for currency has been increasing at the rate of $400,000,000 a month. As of April 14, 1943, six of the Federal Reserve banks had pledged Government securities as collateral for Federal Reserve notes in an amount totaling $505,000,000.

The Federal Reserve System has undertaken to see to it that member banks have reserves which will be adequate at all times to enable them to carry their share of private and governmental financing due to the war program. Purchases of United States Government securities by the Federal Reserve banks in the open market or otherwise in order to carry out this undertaking result in additions to member bank deposits, and to their reserve accounts at Federal Reserve banks against which the Federal Reserve banks are required to hold 35 percent reserves. For Federal Reserve notes issued, the Reserve banks are required to provide collateral, dollar for dollar, in the form of eligible paper of which the

Federal Reserve banks hold very little, or of gold or of United States Government securities.

Senator DANAHER. Is there not a percentage basis connected with that matter?

Mr. ECCLES. You have to have not less than 40 percent of gold against the notes, and 35 percent of gold against the deposits. In the case of the notes the additional 60 percent may either be covered with gold, Government securities, or eligible paper. The banks have no eligible paper, and therefore they must cover with gold or Government securities. There is not sufficient gold to cover, so there is only one way they can continue to issue currency, and that is to have an extension of this bill to permit them to continue to issue Government securities to make up such part of the 60 percent as they are unable to cover with gold certificates.

Senator DANAHER. All right.

Mr. ECCLES. I continue reading:

In these circumstances, if the authority to pledge Government securities as collateral for Federal Reserve notes should be allowed to expire, the Federal Reserve banks could not continue to meet the combined requirements of reserves against deposits and collateral for Federal Reserve notes due to the heavy credit requirements of war financing. Accordingly, it is urged that the authority to pledge Government securities against Federal Reserve notes be extended.

Mr. Chairman, that is about as brief a statement as could be made as to the purpose of this request for extension.

The CHAIRMAN. I think that is a very clear explanation. Are there any questions by members of the committee?

Senator DANAHER. Mr. Eccles, in the Second War Powers Act, title 4, we amended the proviso in subsection (b) of section 14 of the Federal Reserve Act by writing in this language:

Provided, That any bonds, notes, or other obligations which are direct obligations of the United States or which are fully guaranteed by the United States as to principal and interest may be bought and sold without regard to maturities either in the open market or directly from or to the United States; but all such purchases and sales shall be made in accordance with the provisions of section 12A of this act and the aggregate amount of such obligations acquired directly from the United States which is held at any one time by the 12 Federal Reserve banks shall not exceed $5,000,000,000.

In what way will section 14 as thus amended be related to section 16, as amended?

Mr. ECCLES. I do not see that it has any relation to it.

Senator DANAHER. Is there no limitation under section 16, as it now stands?

Mr. ECCLES. No.

Senator DANAHER. Let me call your attention specifically to what is in my mind, and I am reading from section 16 of the Federal Reserve Act, as amended:

The collateral security thus offered shall be notes, drafts, bills of exchange, or acceptances acquired under the provisions of section 13 of this act, or bills of exchange endorsed by a member bank of any Federal Reserve district and purchased under the provisions of section 14 of this act—

and I omit anything further there.

Mr. ECCLES. Is it not a fact that that refers to the various forms of eligible paper that can be used as collateral for the securing of Federal Reserve notes?

Senator DANAHER. I think it is.

Mr. ECCLES. I think that is what that language refers to. If member banks were borrowing extensively from the Federal Reserve banks by rediscounting eligible paper, Federal Reserve banks, of course, would have sufficient of that paper to take the place of the Government securities, so this would not be required. It was, without question, the original conception of the Federal Reserve Act that the volume of currency would expand and contract with the volume of agricultural and commercial business and the expansion of business would be met by rediscount with Federal Reserve banks.

But we have seen, of course, that in practice it just does not work out, that there is little or no relationship between expansion of currency and expansion or contraction of business. For instance, we found during the time of the bank holiday the volume of currency was the greatest it had ever been up to that time, whereas the volume of business was the lowest it had been.

Senator TAFT. Would it not be more correct to say, there is very little relation between the necessity of banks to borrow money from the Federal Reserve System and the amount of currency that is needed? I mean, a larger volume of business will undoubtedly draw more currency.

Mr. ECCLES. Ordinarily you would expect that to be true, but it depends on so many other factors.

Senator TAFT. In other words, there are other circumstances surrounding that matter?

Mr. ECCLES. Yes. For instance, you may get a large volume of currency, such as you have at this time, with practically no bank borrowing because the Federal Reserve System provides reserves to the banks by open-market operations, so that the banks do not have to provide reserves for themselves through a rediscounting with the Federal Reserve. We know they are disinclined to rediscount. There is an unwillingness on the part of banks to borrow from the Federal Reserve banks. They sell Governments first. So the Federal Reserve System keeps the Governments instead of getting their customers' paper.

Senator TAFT. Am I not correct in this, that insofar as the Second War Powers Act is concerned, that merely puts a limit on the amount a Federal Reserve bank may buy directly from the Government?

Mr. ECCLES. That is right.

Senator TAFT. There is no limit on the amount of Government bonds they may hold or acquire from banks.

Mr. ECCLES. There is practically no limit on the amount of the securities they can hold in their portfolios. The limit, as you say, is on the amount they may hold at any one time representing direct purchases. We could purchase a good deal more than $5,000,000,000 directly from the Treasury, but we could not hold more than that at any one time.

Senator TAFT. Will you tell me how much this Second War Powers Act has been availed of?

Mr. ECCLES. I do not have the figures with me, but it has been availed of quite a good deal, particularly as to the overdraft provision. In other words, just before this financing, for instance, and at the different tax periods, the Treasury have overdrawn their account in the Federal Reserve banks by as much as a billion dollars, and they give to the Federal Reserve banks one-day certificates, which are renewed from day to day, representing the borrowing, which is really a direct purchase under that provision.

Now, with the large amount of financing that was ahead of the Treasury it was desirable to have their balances at a very low point, and going even to the extent of having no balance with the Reserve banks, and even an overdraft. As the funds commence to come in and they extinguish the overdraft, that operation of the direct purchase under this authorirty is extinguished.

Senator TAFT. So this authority has been availed of in emergencies as you originally knew it would be.

Mr. ECCLES. That is right.

Senator TAFT. Have those direct purchases, then, been liquidated as a rule?

Mr. ECCLES. The direct purchases have been liquidated insofar as they were used in the case of an overdraft. In the case of the certificates—1-year ⅞-percent certificates—I think upon two occasions as they have fallen due the Federal Reserve—and I think one occasion was in January, when there was a $1,600,000,000 maturity—the Treasury increased that to $2,000,000,000, or a $400,000,000 increase. The Federal Reserve owned a substantial amount of those maturing certificates. We put a bid in directly for the portion that we held. We got, however, the same allotment that the banks got on those particular certificates.

Again, in the case of the maturity, I think as of May 1, the Treasury offered to all holders of certificates maturing on May 1 the right to replace the certificates they had with the new offering, and we replaced the securities we had. However, these certificate transactions were exchanges and not direct purchases.

Senator TAFT. All of your purchases related to short-term securities.

Mr. ECCLES. The only purchases we have made direct are those we would define as overdraft credits. We have done no other direct purchasing.

Of course, as maturities come along, bonds and notes, it has always been the custom of the Treasury to go to the holder of those maturing certificates with the right of exchange. That is not considered a direct purchase where the Treasury gives rights; and the System has always, when it held bonds and refunding was offered in exchange, availed itself of the exchange. But at no time have we added to the portfolio an amount of securities except in the case of overdraft, which has been rather shortly extinguished.

Senator DANAHER. Mr. Eccles, you are now seeking an extension of section 16 authority for 2 years?

Mr. ECCLES. That is right.

Senator DANAHER. If you were required to make a decision at this time would you not be bound to tell us that in 2 years you will be back asking for a further extension?

Mr. ECCLES. I have been trying for a long while to get this made a permanent portion of the legislation, but there has been some objection to it; and it was not of sufficient importance to make an issue of it.

Senator DANAHER. You just thought we would extend it?

Mr. ECCLES. It was not of sufficient importance to make an issue of whether it should be extended or made permanent. There is no question in my mind that we will be extending it indefinitely, possibly during the rest of my lifetime.

Senator DANAHER. One more question on that point: In section 16 appears this sentence:

> At the close of business on such date—

and that of course now with this amendment would be June 30, 1945. That is the date you are asking for.

Mr. ECCLES. Yes.

Senator DANAHER. I will begin again:

> At the close of business on such date, or sooner should the Board of Governors of the Federal Reserve System so decide, such authorization shall terminate and such obligations of the United States be retired as security for Federal Reserve notes.

Just so that the record will show it, what would be the operation, and what would be the consequence were we not to extend this?

Mr. ECCLES. We would either have to quit issuing Federal Reserve notes to meet the requirements and have to cease supporting the Government security market, or we would just have to ignore the provision of the statute. It would be either one or the other. Either course would seem to be a rather disastrous course for us to pursue. I doubt if the Board would take the responsibility of acting contrary to statutory authority. If they did not that would put quite a responsibility on the Congress for what might happen if there were no longer currency paid out and if the Government security market were allowed to get in that position. In other words, if the war financing were not supported, and the reserves necessary to banks to support it were not provided, I can imagine some very uncertain conditions, to say the least, could develop. It is a rather imperative thing that this power be extended under all the circumstances. It would be very serious if it were not extended.

Senator TOBEY. And might put quite an onus on the Banking and Currency Committee.

Mr. ECCLES. Well, if the responsibility were put where it belonged, in case that is where it did belong.

Senator TOBEY. You said there was some objection to making this part of the act permanent. Was that in your Board or from the outside?

Mr. ECCLES. No. There was no objection on the part of the Board.

Senator TOBEY. Has there been any objection in the case of the Treasury Department?

Mr. ECCLES. No. As a matter of fact, Senator Glass is the one who objected. He was the sponsor of the bill, along with Congressman Steagall, in 1943, and, as I understand, at that time he considered it a temporary emergency and was unwilling to have it continue for more than 2 years, and has continued to feel the same way about it.

The CHAIRMAN. And still does, I believe.

Mr. ECCLES. Congressman Steagall does not feel that way about it. As a matter of fact, Congressman Steagall feels that it should be a permanent requirement. In fact, Congressman Steagall would go so far as to say, "Why put collateral back of Federal Reserve notes?"

Senator TAFT. Whether, after all, there is some justification for a temporary provision, do you not think it will be necessary to revise the whole System before very long?

Mr. ECCLES. I think so.

Senator TAFT. We started an investigation in this committee to do that very thing, and then the war held it up. I think we still have that authority probably.

The CHAIRMAN. We have no money.

Senator RADCLIFFE. Whether you make it permanent or temporary, that would not make a particle of difference in your operation, I take it.

Mr. ECCLES. None at all.

Senator RADCLIFFE. In other words, if it were made permanent or only for 2 years, that would not make a particle of difference in your operations.

Mr. ECCLES. No. And that is the reason we do not press for the provision to be made permanent. It is entirely satisfactory to have it on a 2-year basis if Congress so prefers. If you wish us to come up here every 2 years, all right.

The CHAIRMAN. Are you willing to come up here every 2 years with that request?

Mr. ECCLES. Certainly.

Senator MURDOCK. Governor Eccles, this bill has caused a great deal of talk among Members of Congress as to just what happens under it. As I understand the situation, your 40 percent gold requirement is in no way affected by this set-up?

Mr. ECCLES. No. It is in no way affected by this. That is another provision.

Senator MURDOCK. But by including direct Government obligations as collateral for Federal Reserve notes, that means, does it not, that your 60 percent, which under the original act was eligible paper, can now be supplied by direct obligations of the Government?

Mr. ECCLES. Yes.

Senator MURDOCK. Whenever you take advantage of this act, of what we have now, that is 40 percent gold reserve plus 60 percent direct obligations of the Government behind Federal Reserve note issues.

Mr. ECCLES. Well, you only use Government securities to the extent that you have not enough gold to cover, not only the 40 percent but the 60 percent. If you could cover the Federal Reserve notes with 100 percent gold you would have no occasion to use Government bonds as collateral.

Senator MURDOCK. I understand that.

Mr. ECCLES. But to the extent that you have not sufficient gold to give 100-percent coverage you can use Government securities under the provision of this act up to 60 percent.

Senator MURDOCK. But never above 60 percent.

Mr. ECCLES. No.

Senator MURDOCK. There must always be 40 percent of gold in addition to direct obligations of the Government.

Mr. ECCLES. That is the reason the bill was passed in 1932, because the supply of gold was diminishing. As you know, there was a good deal of gold hoarding and gold exporting at that time. There was no embargo on gold exports. We were losing gold by way of export, and gold was being hoarded, and the volume of commercial paper was getting less, so this act was passed in 1932 to meet the emergency.

Senator TAFT. What is the amount of Federal Reserve notes outstanding at this time?

Mr. ECCLES. I do not recall the total currency outstanding. It is between $16,000,000,000 and $17,000,000,000, but just how much of that is silver certificates I cannot say offhand; and then, of course, there are Federal Reserve bank notes. And there are some old bank notes still out that have not as yet been redeemed.

Senator TAFT. What are the gold-certificate holdings of the banks?

Mr. ECCLES. The total amount of gold, I believe, is about $22,000,-000,000.

Senator MURDOCK. It is a little over $22,000,000,000 that you have by way of gold certificates.

Mr. ECCLES. I think so, or around that amount. But you have to cover deposits as well with 35 percent of gold or lawful money. That is, deposits of member banks.

Senator TAFT. Mr. Eccles, I think those figures would be very interesting to have in our record. Could you give us that information?

Mr. ECCLES. I will be very glad to do that. What you would like to know is the amount of Federal Reserve notes outstanding?

Senator TAFT. That is right.

Mr. ECCLES. And what was your other question?

Senator TAFT. And give us the amount of deposits, and how much gold is held against deposits, and how much gold is held against notes and how much gold is held against Federal bonds.

Mr. ECCLES. As to bonds held against Federal Reserve notes, it amounted to $505,000,000, as of April 14.

Senator MURDOCK. Senator Taft, would it not be a great deal more informative if we could have a picture of the situation such as this, a picture showing us how it has increased over, say, the last 3 or 4 years, beginning back in 1939; and then showing, year by year, how the Federal Reserve note issue has increased? I think we would have a very much better view of the situation in that way.

Senator TAFT. I will be glad to have the data furnished to us in such fashion as will give a picture of the situation.

(The following table was subsequently submitted by Mr. Eccles in response to Senator Taft's request.)

Federal Reserve notes outstanding, collateral pledged as security therefor, reserves, and deposit and Federal Reserve note liability of the Federal Reserve banks on Apr. 30, for the years 1939 to 1943

[In thousands of dollars]

	Apr. 30, 1939	Apr. 30, 1940	Apr. 30, 1941	Apr. 30, 1942	Apr. 30, 1943
Federal Reserve notes outstanding	4,736,362	5,250,016	6,409,594	9,239,843	13,646,063
Collateral security for Federal Reserve notes outstanding:					
Gold certificates	4,872,500	5,374,500	6,514,000	9,365,000	13,294,000
Eligible paper	3,106	1,065	2,792	6,693	9,988
Government securities					550,000
Total	4,875,606	5,375,565	6,516,792	9,371,693	13,853,988
Total gold certificates held by Federal Reserve banks and Federal Reserve agents	13,103,064	16,427,615	20,112,111	20,509,962	20,303,213
Total cash reserves	13,475,578	16,808,808	20,436,220	20,824,092	20,656,476
Total deposits of Federal Reserve banks	11,375,575	14,152,433	16,272,115	14,204,002	14,130,643
Federal Reserve notes in actual circulation [1]	4,457,868	4,941,165	6,143,059	8,821,063	13,127,756

[1] Federal Reserve notes outstanding less notes held by the issuing Federal Reserve bank.

Mr. ECCLES. There was sufficient gold to give 100 percent coverage until last fall. What has happened during the past year has been a cessation of gold imports. As a matter of fact, I think there has been some slight loss of gold, and a very large increase in Federal Reserve notes.

Prior to 1940 and for a considerable period of time there was a large annual increase in gold imports, which increased of course the gold certificates. And the increase in currency was not as important a factor as it has since become. It was taken care of to some extent by the expansion of silver certificates. Silver certificates took the place of all dollar bills and $5 bills; and I think they cut into and took the place of a good many $10 bills. There were no Federal Reserve $5 bills being issued. And, of course, they completely monopolized the $1 bill requirements.

So that the amount of gold certificates necessary to back the Federal Reserve notes was no problem for quite a long period of time. Gold was expanding and the Federal Reserve note issue was not expanding. Now the reverse is true. If anything the gold supply is contracting, and the silver certificates are not expanding as they were. Federal Reserve notes are providing for the greatly increased demand for currency; and that is a development within the past year.

Senator MURDOCK. Governor Eccles, would not this be a very opportune time to issue the remaining silver certificates we could issue against present bullion silver held in the Treasury?

Mr. ECCLES. There is no reason for it. I cannot see that it would serve any purpose. There is this thing about Federal Reserve notes, that they are elastic in that you can provide for expansion and contraction, whereas in the case of silver certificates that is not true. When they are once issued there is no means of contracting them. They become a fixed, permanent outstanding issue.

And, of course, as you know, Senator Murdock, I have never seen any justification for the issuance of silver certificates, and would have much preferred having no silver certificates issued. I would have felt that we had a very much better currency system if we had relied upon our central banking mechanism to provide the currency necessary to meet both expansion and contraction; to meet the needs of the Government as well as the needs of commerce, agriculture, and industry.

Senator MURDOCK. However, we are finding today in the different theaters of war that there is a premium on both gold and silver coins. I am just wondering, now that silver has become so intrinsically valuable in our war program, if it would not be a much better backing for our money than the system we are now extending, and that is merely to put the Government bond behind paper. I think it would be better to issue silver certificates.

Senator TAFT. But the silver certificate is not an obligation of the United States to pay a dollar except in silver; and the silver itself is not worth a dollar except as the value may be conferred by the currency privilege. There is some question whether you have as good backing in the case of the silver certificate as in the case of the Goveernment promising to pay you a dollar.

Senator MURDOCK. A Government Reserve note is not a promise to pay anything other than the dollar. If you ask the Secretary of the

Treasury what is legal money I do not think you will get a satisfactory answer. I have never had a satisfactory answer except the silver dollar.

Senator RADCLIFFE. Senator Murdock, do we not have here the old controversy between mind and matter?

Mr. ECCLES. I do not think the people would be very much interested in either a silver certificate or a gold certificate if all it could purchase were a certain number of ounces of silver or a certain number of ounces of gold. I do not think the people are interested in having money because of the metal that it may be converted into. They are not interested in having the metal. It seems to me it is a fiction to them that money is better because backed with metal than if not so backed. I have the same doubt about gold as I have about silver so far as that is concerned. Money value, after all, is what it will buy in terms of goods and services that people want. You can have money buy more or less in goods and services without regard to the metal content of the money.

The idea once was that because currency was convertible into metal, either gold or silver, so long as it was tied to the metal you were protected against inflation. Of course, that is foolish. We have found that we could have the most serious kind of deflation with the same gold content; that you could have not only serious deflation without changing the gold content, but you could have serious inflation on the basis of the same gold content.

So that convertibility of currency into metal does not stabilize the currency in terms of goods and services it can buy. That was, of course, the idea—that it would stabilize currency. And the only justification for the conversion of currency into metal was for the purpose of stabilizing the purchasing power of your money.

Senator RADCLIFFE. I just asked Senator Murdock if that was not a reviewing of the old controversy between mind and matter.

Mr. ECCLES. And he did not answer your question.

Senator RADCLIFFE. He is thinking it over.

Senator MURDOCK. I was so interested in what Governor Eccles was telling us that I did not take the time to answer. I doubt very much if we could convince our soldiers who are having trouble getting rid of paper dollars that there is not some virtue in metal money.

Mr. ECCLES. Of course, gold has served some purpose in the international field. It is the yardstick of international currency and marketing. It has served as such in the past. In the international market you have to tie currency to something; have all currency tied to the pound, or to the dollar, or to something else. You have to tie it to something. That currency in turn may be tied to gold. On the other hand, of course, we have seen a number of countries manage their internal economy without the use of gold, and they have done it pretty effectively.

The CHAIRMAN. Without either gold or silver.

Mr. ECCLES. Yes; without either gold or silver as a backing for their currency. The Russians have no gold or silver as a backing for their currency, and neither have the Germans.

The CHAIRMAN. But the Russians have a good deal of gold.

Mr. ECCLES. Yes; but they sell it to us at $35 an ounce and buy something they wish that has some utility value. Gold to them has no utility value. So they sell it to us for what has a real utility value.

Senator TOBEY. You are speaking now of the present Russian Government and not the old Czarist Government?

Mr. ECCLES. Yes.

Senator MURDOCK. One more question: Governor Eccles, you made the statement when you first began that in 1932 and 1933 we had the greatest quantity of currency that was ever in circulation.

Mr. ECCLES. Up to that time; yes.

Senator MURDOCK. And still we were suffering from very serious deflation, very serious depression. I think you further stated that that indicated there was no relationship between the prosperity of the country, or the volume of business of the country, and the amount of currency in circulation.

Mr. ECCLES. What I should have said was that there was not necessarily a relationship. There was an exception there certainly.

Senator MURDOCK. And now we find the greatest amount of currency that was ever in circulation, and of course, the greatest prosperity the country has ever seen. I am wondering if the currency in circulation, being such a small part of the entire quantity of money that is used to do business, justifies the statement you made. I cannot help but think that the money in circulation, including your demand deposits as well as your currency, all taken together, have a very direct bearing on the volume of business done.

Mr. ECCLES. Yes. If you are going to take bank deposits into account, that is true.

Senator MURDOCK. We have to do that.

Mr. ECCLES. Certainly there is some relationship between the quantity of money in circulation and business activity. There is no direct relationship. Certainly there is no formula that you could make by the use of which you could say a given volume of money would produce a given volume of business. The turn-over of your funds is such an important factor.

You could support a much larger volume of business than we are now supporting in this country, at this price level, on less money than we now have. The velocity or turn-over of funds is very slow.

During the twenties we had a much larger volume of business on the available supply of money than we have had at any time since. So that it seems to me the quantitative theory of money has been pretty largely exploded as a result of what has happened during the last 10 years or 20 years.

Senator TAFT. Would you not say volume of money is the result of prosperity rather than the cause?

Mr. ECCLES. It is difficult to say which is which because of the effect of the overlap. Certainly a given volume of funds does not necessarily produce prosperity, but if you have a given quantity of funds and you get prosperity, the volume of funds is likely to expand as business activity increases.

There is this explanation that I would like to make, Senator, that the volume of currency, as I have indicated, is not necessarily directly related to the volume of business activity, because it will depend to a great extent upon whether, for instance, the currency goes in hoarding for some reason or other, as it did in 1932 and 1933. It will depend upon the type of activity you have.

The war activity we have now has merely increased the volume of currency, far out of proportion to business activity, because of the large amount being used to pay soldiers, not only within this country but throughout the world. They are away from home and need to carry currency. Then, too, you have the great number of war workers who are away from their homes and carry a larger amount of currency than usual.

Then there was the action taken to freeze foreign balances in this country. If you will recall, that ocurred in 1939, 1940, and 1941. That caused considerable hoarding of currency on the part of foreigners in this country who did not understand the situation and did not know whether their money might be frozen even though many of them were citizens of this country.

Then the banks have increased their service charges in order to meet increased expenses, tending to offset the loss of interest and the loss of loans. In other words, as to the smaller accounts that were unprofitable, accounts that issued a good many checks in relation to the size of the balances, the banks have undertaken either to put them on a profitable basis or to make their charges sufficiently high to get rid of them.

That is another factor that has increased the volume of currency. I merely mention these factors to indicate that the volume of currency could be greatly influenced outside of the volume of business activity.

Senator Radcliffe. Referring to an expression you used awhile ago, you said in substance that gold formed some use as a yardstick or measure of value. Does it not also render a use as a source or element of value besides merely a yardstick?

Mr. Eccles. I do not see how. I cannot see where its element of value comes in except as it is exchangeable for something people want.

Senator Buck. Did I understand you to say that only about a year ago there was enough gold to cover reserve notes?

Mr. Eccles. Yes; until last fall.

Senator Buck. That was the first time that occurred, was it?

Mr. Eccles. We had to cover them in 1932, 1933, 1934, and 1935. Subsequently, the large inflow of gold provided sufficient gold to give a 100-percent cover without Government securities. Then, commencing last October, with the continued expansion of Federal Reserve notes and the cessation of the inflow of gold, we had to pledge Government securities again.

Senator Buck. That is the only time since the depression when you have had to make use of this provision?

Mr. Eccles. Yes, sir; since last fall. Well, in 1934, 1935, and 1936, but the gold continued to come in, providing adequate cover, and silver certificates in part, took care of the circulation. There was not the expansion of Federal Reserve notes that is now required.

Senator Taft. If there are no more questions, I wish to ask a question, Mr. Chairman.

The Chairman. I think Senator Taft suggested that Mr. Eccles furnish us with a statement of the amount of gold now here. Do you mean the gold that we own and not the gold that we are the custodian of?

Senator Taft. The gold that the Federal Reserve controls.

Mr. Eccles. We have everything except stabilization fund gold.

The Chairman. Is that added to the $22,000,000,000 of gold?

Mr. Eccles. I am sorry, but I could not be certain about that. I think it is $22,000,000,000 including that.

The CHAIRMAN. I think so, too. Then you were going to tell us the amount of Federal Reserve notes outstanding.

Mr. ECCLES. That is right.

The CHAIRMAN. Why not tell us about the amount of eligible paper?

Mr. ECCLES. We have practically none of that.

The CHAIRMAN. There is some, I believe.

Mr. ECCLES. Maybe a few hundred thousand dollars. It is insignificant, and would not take care of the currency for a day.

The CHAIRMAN. All right. If that is not important.

Mr. ECCLES. I do not know that there is even any of it, as a matter of fact.

The CHAIRMAN. I believe you made a report on the bill introduced by Senator Taft.

Senator TAFT. I introduced S. 658 in relation to section 18 of the Federal Reserve Act, which provides for the issuance of Federal Reserve bank notes. That was an emergency section adopted in the depth of the depression, and was to expire at the expiration of the emergency as declared by the President. But the President has never declared an end of the emergency of 1933, and therefore Federal Reserve banks availed themselves of this section to issue about $600,000,000 more currency.

Eliminating any controversy as to power, and assuming they had the power to do it, it seemed to me clear the statute ought to be repealed. If they could issue $600,000,000 of Federal Reserve bank notes, they could issue $6,000,000,000 Federal Reserve bank notes in the same way. There is no limit on that power. The emergency is over.

Both the Treasury and the Federal Reserve System have sent in reports that this would be agreeable to them, but that they have objection to section 2, in which I proposed that the $600,000,000 already issued be retired as the bank notes come in. They say they do not want to have to reprint them, and wish to reissue them in the same way.

I am willing to eliminate section 2. With that exception I understand there is no objection to the bill. I think the section only complicates the situation. Federal Reserve notes are the usual and proper way to obtain currency, and I do not know why there should be any longer this emergency provision for Federal Reserve bank notes.

The CHAIRMAN. What is the collateral for Federal Reserve bank notes? Only bonds?

Mr. ECCLES. No. You can put up anything that was accepted by the Federal Reserve banks.

Senator TAFT. What happened was this: They put up Government bonds and withdrew them immediately, and the notes that are out have nothing behind them. I do not want to question the legality of it or get into that controversy, but at the same time do not think the statute ought to stand on the books. The Treasury said they used it simply because they found $600,000,000 of those old notes and could save a good deal of money in the way of printing.

Senator RADCLIFFE. Does that fix a limit at $600,000,000?

Senator TAFT. No. They just cannot use it any more.

Senator RADCLIFFE. That means they cannot go beyond $600,000,000?

Senator TAFT. That is right. There may be some old ones out. How about that, Mr. Eccles?

Mr. ECCLES. There may be a few, but I could not say about that.

Senator DANAHER. I think it is about $13,000,000.

Mr. ECCLES. When I appeared before you 3 or 4 months ago I think that was true.

Senator MURDOCK. Is there any limitation on what you can issue by way of Federal Reserve bank notes?

Mr. ECCLES. I think for all practical purposes that is about true. I suppose there would be a limit at some point along the road.

Senator TAFT. I do not see why there would be. You keep handing back and forth the same bonds.

Mr. ECCLES. Yes. I suppose you could continue using them for a long period of time.

Let me say this for the purpose of the record: I think that Senator Taft might have given the impression here that the Treasury was responsible for the issuance of those notes. It was really the Federal Reserve System. The Federal Reserve banks were the ones that raised the question in the first instance; people on the outside of Washington, people who were anxious to use this currency.

Senator TAFT. Because they have to pay for the printing of it.

Mr. ECCLES. That is right.

Senator TAFT. They thought they could save on that.

Mr. ECCLES. It had been sent out to them. It was in their vaults, and they had paid several hundred thousand dollars, I think, for the printing and for express charges and other costs involved, and they wanted to use it. As a matter of fact, conditions got so tight in the case of one of the Reserve banks that they issued some old currency that was payable in gold they had on hand, because they ran out of Federal Reserve notes.

Senator TAFT. You mean it was stated on the face of the notes that they were payable in gold?

Mr. ECCLES. They had been requested not to pay them out but they simply ran out of currency. The Bureau of Printing and Engraving had got so far behind in its work that they were just right up against it. We decided that here were these notes that we could ship in and destroy them, or we might use them and in a comparatively short time they would be worn out and would disappear. There was no thought, I am certain, on the part of the Federal Reserve System of using this power to print new currency. Therefore we do not have the slightest objection, and neither does the Treasury, to retiring the provision.

Senator TAFT. You will remember the memorandum from the Federal Reserve System to the effect that the authority of Federal Reserve banks to issue Federal Reserve bank notes will expire when the President proclaims the emergency of March 6, 1933, has terminated. All that this bill does is to say that that emergency has terminated. So I do not really see that there is any great question about it.

Senator CLARK of Idaho. Mr. Eccles, is that the transaction that Professor Spahr got exercised about?

Mr. ECCLES. That is the one.

Senator CLARK of Idaho. Has he any sense at all?

Mr. ECCLES. Well, he did not show very much, to my way of thinking in this instance. In putting this act all out of focus and making it appear this was an inflationary danger he missed completely where the inflationary dangers are. He picked out a matter that he construed to be fraught with inflation danger.

It is not any more inflationary to use this kind of currency than to use any other kind of currency. It is no more inflationary to use this kind of currency than to expand deposits. So from the standpoint of judgment he seemed to use in connection with this act, I cannot see that he exhibited any very great degree of intelligence.

Senator CLARK of Idaho. Did you read his article in the Saturday Evening Post on silver?

Mr. ECCLES. No; I did not.

Senator DANAHER. Mr. Eccles, did you look over that copy of Senator Taft's bill that I handed over to you?

Mr. ECCLES. Do you mean the section 2 amendment?

Senator DANAHER. Yes. Will you read it?

Mr. ECCLES. As I have it here section 2 reads as follows:

> All Federal Reserve bank notes issued under the authority of section 18 of the Federal Reserve Act received by any national bank or by any Federal Reserve bank, shall when presented to the Treasury for payment be paid and be retired.

That is the language.

Senator TAFT. There is another section that provides for the retirement of Federal Reserve bank notes.

The CHAIRMAN. As a matter of fact, are they not retired in about 18 months?

Mr. ECCLES. Well, they run out much faster than that, as a whole, but it may be there will be certain of them that would not be retired for years. Somebody might put them away in a strong box and they will get out of circulation.

Senator DANAHER. If section 2 were amended as this states, would not that accomplish the desired end and actually provide the mechanism for the retirement of the issue?

Mr. ECCLES. It seems to me it would. What I understand you want to accomplish is that as these notes are worn out they will not be reissued; that you do not want to stop the Federal Reserve banks from paying them out again if they are not ready for mutiliation or retirement.

Senator MURDOCK. You destroy the very purpose of issuing them if you retire them before they are physically unfit to circulate.

Mr. ECCLES. That is right. There would seem to be no sense in retiring them before they would be considered unfit for circulation, which is, of course, the way we retire all currency. The only difference here is that you could not reissue these when they reach that condition; whereas you do replace with new currency silver certificates and Federal Reserve notes as they become unfit for circulation.

The CHAIRMAN. Well, we have had a very interesting discussion.

Mr. ECCLES. This is really an aside, but in my opinion there would have been no reason for providing for the issuance of Federal Reserve bank notes at all in 1932——

Senator TAFT (interposing). If you had the Glass-Steagall bill.

Mr. ECCLES. If you had eliminated the collateral requirements of Federal Reserve notes. Most of the central banks do not require collateral back of central bank notes. Notes of central banks provide the currency of the realm and they are guaranteed by the Government. To my way of thinking it does not make sense to require collateral back of currency guaranteed by the Government.

Senator TAFT. I do not want to get into a discussion of the question, but there is no limit on the issuance of gold notes except the dollar limit in the law, which the Congress could change tomorrow. That is the way we have had inflation, from excessive currency issues, in different parts of the world. It has been easy where it was unsecured, and they went from one figure to another.

Mr. ECCLES. Inflation does not come that way. Inflation comes from the public deficit always. Inflation comes out of a public deficit, and the public deficit is then financed by the central bank.

Senator TAFT. Are you not more likely to have a deficit if a government can just issue paper for the payment of bills? It is largely a psychological question. There should be some restriction on issuing unsecured Government notes. When you come back for a complete change of the banking law we can consider the matter of method.

Mr. ECCLES. You can take any restriction off just as you are taking this off now, or you are extending the provision to meet the requirements and you might just as well take the restriction off as to say you can use Government securities as collateral. If you take it off that language itself is not limited. A Government security is a promise to pay, and a Federal Reserve note guaranteed by the Government is recognized as the currency of the country. It is not redeemable in gold, and neither is a Government bond payable in gold. A Government bond that goes out as collateral is payable in the money that it secures. It does not make sense.

Senator RADCLIFFE. But if you have an instrument available, that helps a little bit.

Mr. ECCLES. A bond is good in the minds of the people because they can cash it in and get currency. Currency can buy the bond. They are almost interchangeable. The idea of putting up bonds as collateral certainly does not help the security, and it does not limit the amount that you are going to issue. And no other collateral that you acquire back of Federal Reserve notes will ever govern the amount you will use. You will use Federal Reserve notes required by the public to meet the demands of the public upon banks. If the public have deposits in a bank and they call upon the bank for money, then we are going to provide that money, and Congress will make it possible to provide it, and they will provide it without limit. Otherwise your whole economy collapses.

Senator DANAHER. Mr. Chairman, the pending question before the Senate is the amendment I offered. I must leave now but will vote for both bills.

The CHAIRMAN. If no member of the committee wishes to ask a further question we will now take up the bills.

What is your wish with reference to S. 1041, extending the second paragraph of section 16 of the Federal Reserve Act, as amended, to June 30, 1945?

Senator RADCLIFFE. I move that we report the bill favorably to the Senate.

Senate TOBEY. I second the motion.

The CHAIRMAN. It has been moved and seconded that we report the bill favorably to the Senate. All in favor of that motion will make it known by saying aye. [A chorus of ayes.] Those opposed will say no. [Silence.]

The ayes have it, and it is so ordered.

The next is S. 658, the bill offered by Senator Taft as amended.

Senator TAFT. I move that the bill be favorably reported to the Senate.

Senator RADCLIFFE. I second the motion.

The CHAIRMAN. It has been moved and seconded that S. 658 as amended be reported favorably to the Senate. All in favor of that motion will make it known by saying aye. [A chorus of ayes.] Those opposed will say no. [Silence.]

The ayes have it, and it is so ordered.

The committee will now stand adjourned.

(Thereupon, at 11:50 a. m., Tuesday, May 4, 1943, the committee adjourned.)

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