REDUCTION IN RESERVE RATIO FOR FEDERAL RESERVE NOTES AND DEPOSITS

HEARINGS

BEFORE THE

COMMITTEE ON BANKING AND CURRENCY
HOUSE OF REPRESENTATIVES

SEVENTY-NINTH CONGRESS

FIRST SESSION

ON

H. R. 2124

A BILL TO AMEND SECTIONS 11 (C) AND 16 OF THE FEDERAL RESERVE ACT, AS AMENDED, AND FOR OTHER PURPOSES

FEBRUARY 27, MARCH 1 AND 5, 1945

Printed for the use of the Committee on Banking and Currency

UNITED STATES
GOVERNMENT PRINTING OFFICE
WASHINGTON : 1945

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REDUCTION IN RESERVE RATIO FOR FEDERAL RESERVE NOTES AND DEPOSITS

TUESDAY, FEBRUARY 27, 1945

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Washington, D. C.

The committee met at 10:30 a. m., Hon. Brent Spence (chairman) presiding.

The CHAIRMAN. We have met this morning to consider H. R. 2124, a bill to amend the Federal Reserve Act.

(The bill is as follows:)

[H. R. 2124, 79th Cong., 1st sess.]

A BILL To amend sections 11 (c) and 16 of the Federal Reserve Act, as amended, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) the third paragraph of section 16 of the Federal Reserve Act, as amended, is amended by changing the first sentence of such paragraph to read as follows:

"Every Federal Reserve bank shall maintain reserves in gold certificates of not less than 25 per centum against its deposits and reserves in gold certificates of not less than 25 per centum against its Federal Reserve notes in actual circulation: *Provided, however,* That when the Federal Reserve agent holds gold certificates as collateral for Federal Reserve notes issued to the bank such gold certificates shall be counted as part of the reserve which such bank is required to maintain against its Federal Reserve notes in actual circulation."

(b) The first sentence of the fourth paragraph of section 16 of the Federal Reserve Act, as amended, is amended by striking therefrom the words "40 per centum reserve hereinbefore required" and by inserting in lieu thereof the words "25 per centum reserve hereinbefore required to be maintained against Federal Reserve notes in actual circulation".

(c) Subsection (c) of section 11 of the Federal Reserve Act, as amended, is amended to read as follows:

"(c) To suspend for a period not exceeding thirty days, and from time to time to renew such suspension for periods not exceeding fifteen days, any reserve requirements specified in this Act: *Provided,* That it shall establish a graduated tax upon the amounts by which the reserve requirements of this Act may be permitted to fall below the level hereinafter specified: *And provided further,* That when the reserve held against Federal Reserve notes falls below 25 per centum, the Board of Governors of the Federal Reserve System shall establish a graduated tax of not more than 1 per centum per annum upon such deficiency until the reserves fall to 20 per centum, and when said reserve falls below 20 per centum, a tax at the rate increasingly of not less than 1½ per centum per annum upon each 2½ per centum or fraction thereof that such reserve falls below 20 per centum. The tax shall be paid by the Reserve bank, but the Reserve bank shall add an amount equal to said tax to the rates of interest and discount fixed by the Board of Governors of the Federal Reserve System."

SEC. 2. The second paragraph of section 16 of the Federal Reserve Act, as amended, is amended to read as follows:

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"Any Federal Reserve bank may make application to the local Federal Reserve agent for such amount of the Federal Reserve notes hereinbefore provided for as it may require. Such application shall be accompanied with a tender to the local Federal Reserve agent of collateral in amount equal to the sum of the Federal Reserve notes thus applied for and issued pursuant to such application. 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, or bankers' acceptances purchased under the provisions of said section 14, or gold certificates, or direct obligations of the United States. In no event shall such collateral security be less than the amount of Federal Reserve notes applied for. The Federal Reserve agent shall each day notify the Board of Governors of the Federal Reserve System of all issues and withdrawals of Federal Reserve notes to and by the Federal Reserve bank to which he is accredited. The said Board of Governors of the Federal Reserve System may at any time call upon a Federal Reserve bank for additional security to protect the Federal Reserve notes issued to it."

The CHAIRMAN. We will hear first Governor Eccles, Chairman of the Board of the Federal Reserve System.

STATEMENT OF HON. MARRINER S. ECCLES, CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESEVE SYSTEM

Mr. ECCLES. Mr. Chairman and members of the committee, I have a prepared statement which I would like to read for the record as the basis of any discussion that may follow.

The CHAIRMAN. You may proceed.

Mr. ECCLES. The bill under consideration (H. R. 2124) would accomplish the following purposes: (1) Extend indefinitely the authority of the Federal Reserve banks to pledge United States Government securities against Federal Reserve notes issued by the Federal Reserve agents. Existing authority expires June 30, 1945; and (2) reduce the requirements of reserves to be held by Federal Reserve banks from their present level of 40 percent in gold certificates against Federal Reserve notes in circulation and 35 percent in gold certificates or lawful money against deposits, to a uniform minimum of 25 percent in gold certificates against combined note and deposit liabilities.

The need for reducing the high reserve requirements of the Federal Reserve banks was mentioned by the President in his Budget message transmitted to the Congress on January 3, 1945.

Pledging of United State Government securities against Federal Reserve notes: In conditions prevailing today, with Federal Reserve notes outstanding in an amount of $21,700,000,000 and deposit liabilities of the Federal Reserve banks in an amount of $16,400,000,000, it is imperative to extend the power to pledge United States Government's as collateral notes. Without this authority the Federal Reserve banks would be obligated to engage in a series of operations for the sole purpose of obtaining other assets that would be eligible as collateral for Federal Reserve notes in place of United States Government securities which would not be eligible. They would have to sell a large enough volume of Government securities to make it necessary for banks to borrow as much as $10,000,000,000 from the Federal Reserve banks at this time and possibly as much as 18 billions by the end of the year. The manner in which this would work is that the Reserve banks would sell the securities in the open market; payment for them would take out an equivalent amount of funds from

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the market, and member banks would have to borrow this amount from the Federal Reserve banks in order to replenish their reserves. The promissory notes of member banks at the Reserve banks would be eligible under the law as collateral for Federal Reserve notes. No public interest would be served, but in the process the market for United States Government war obligations would be disrupted at a time when the Treasury must still raise vast sums to finance the war. It is clear that this must not occur and that, therefore, the power to pledge Government securities against Federal Reserve notes must be continued.

In proposing to permit the Reserve banks to pledge United States Government obligations as collateral for Federal Reserve notes, it is recommended that no time limit be placed on this authorization. In view of the fact that the Federal Reserve banks' assets, other than gold certificates, consist at present almost entirely of Government securities, most of which were acquired during the war, and the improbability that these banks will have any considerable volume of other earning assets in the foreseeable future, it would not be in the public interest to have the authority to use United States Government securities as backing for notes terminate at a predetermined date.

Periodic renewal of this authority not only involves delay, unnecessary expenditure of effort for the Congress and the Board, and the necessity of rehearsing the same arguments over and over again, but it also may result in a period of uncertainty which is disturbing to the United States Government security market. Maintenance of stable conditions in this market is essential in view of the dominant role that Government securities have come to play in our financial structure, and this stability has been and must remain indefinitely a primary objective of Federal Reserve policy. Uncertainty about continued eligibility of Government securities as collateral for Federal Reserve notes would have an adverse effect on this stability.

The pledging of Government securities as collateral was first authorized 13 years ago as an emergency measure at the depth of the depression when the Federal Reserve banks needed to buy Government securities in order to ease the pressure of debt on member banks and thus create easier credit conditions. The authority has been renewed from time to time. I think this is the seventh time it has been requested. It is apparent that it will have to be renewed for many years to come. It would be far wiser to extend the authority for an indefinite period, the Congress of course always retaining the right to repeal the authority if this should appear to be desirable.

When the collateral provisions for Federal Reserve notes were first formulated there were practically no Government securities in the market, member banks had a large volume of so-called eligible commercial paper, and were expected to borrow on that paper when they required additional reserves or currency. The situation has radically changed since then. There is now an enormous public debt which constitutes a large part of the earning assets of member banks; the total volume of eligible paper has declined, and many banks have practically no such paper. Banks are also reluctant to borrow from the Reserve banks and, if they should borrow in considerable volume, this would result in a tightening of credit conditions with disturbing effects on the price of Government securities. Furthermore, if they bor-

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rowed, they would borrow on their promissory notes secured by Government obligations. Consequently, what would be back of the notes would still be United States Government securities—but with an endorsement by a member bank. Surely an obligation of the United States Government is not improved in credit standing by endorsement of some member bank.

Collateral requirements are not an effective limitation on credit expansion by the Federal Reserve banks. Open-market operations of these banks are governed by considerations of the public interest and not of Federal Reserve bank earnings. When the Reserve banks purchase United States Government securities they pay for them by deposit credit. Once these deposit liabilities have been incurred the Federal Reserve banks are obliged to permit their withdrawal in currency. The public demand for currency, in turn, depends on business conditions, activity of trade, the volume of wage payments, the price level, and the extent of the people's wish to hold their liquid assets in the form of cash rather than bank deposits or Government securities. Member banks, to avoid insolvency, must permit their customers to withdraw their deposits in currency; Federal Reserve banks in turn must permit the member banks to obtain the currency by drawing on their balances with the Reserve banks. Consequently, the Reserve banks have no choice in the matter because they have no control over the demand for currency. It serves no useful purpose to encumber these unavoidable operations by legal restrictions which inevitably must give way as soon as they would actually restrict.

In any case Federal Reserve notes have a prior lien on all assets of the Federal Reserve banks and are obligations of the United States Government. Segregation of special assets of the Federal Reserve banks as collateral for these notes adds nothing to their quality. It is merely an absolete piece of machinery conceived at a time when conditions were radically different from those that prevail today. That goes back to 1913, before the First World War. By authorizing the pledging of Government securities as collateral for Federal Reserve notes the collateral requirement is extended to practically all the assets of the Reserve banks and ceases to be an interference with the performance of their duties and the discharge of their responsibilities. This extension should, therefore, be a permanent part of the law.

In this connection, I think it may be well at this time to get a view of what the situation is. You can all see this chart [exhibiting]. You notice that in 1939 about 5 billion was the total of outstanding Federal Reserve notes. It is now about 22 billion and is going up at the rate of about 100 million a week.

You will notice here [indicating] as the defense program started and as we got into the war, how Federal Reserve notes have gone up. At this point [indicating] we had sufficient gold so that it required no other collateral back of the Federal Reserve notes. We had far more than enough gold to cover all of the Federal Reserve notes 100 percent and also to meet the requirements of the 35-percent gold coverage against the reserves of the member banks. As those member bank deposits with the Reserve banks went up, of course it took more gold to provide for the 35 percent coverage. As the Federal Reserve notes went up, it took more gold to cover the Federal Reserve notes, so that you get up to the point here [indicating], with the notes continuing

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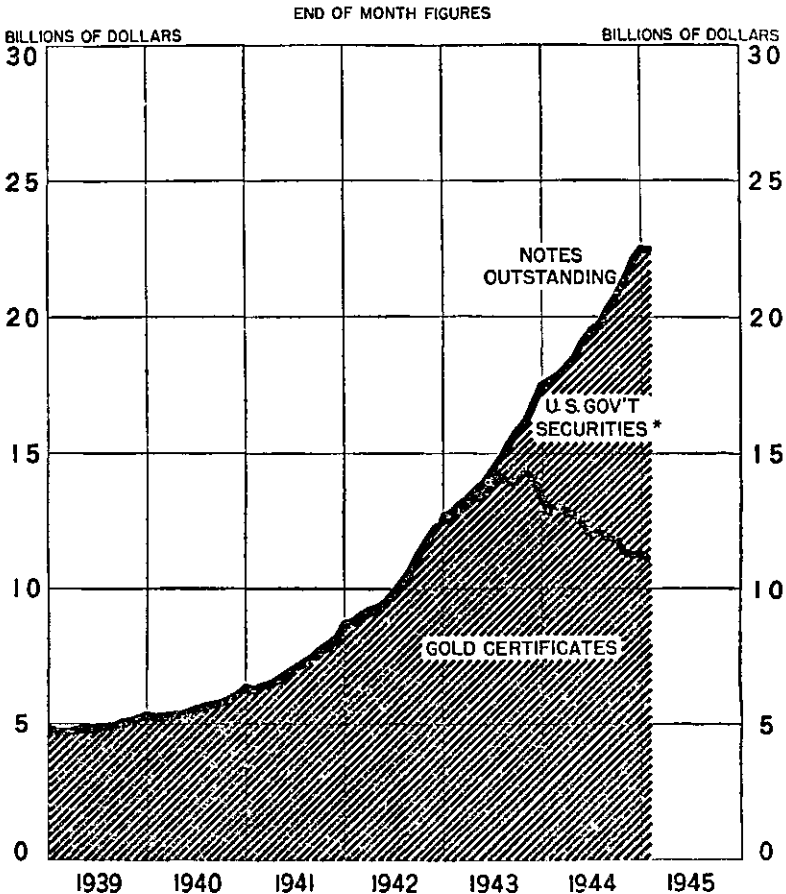
CHART 1



to go up, where you run out of gold coverage; so we had to cover the difference with Government securities.

I just wanted you to get in mind the trend of gold certificates and outstanding notes and the amount of Government securities pledged back of the notes as long as there is collateral required and as long as the Reserve banks have no other assets—practically no other assets—and so long as they must meet a demand for currency—they have no choice but to pledge Government securities when gold is used up. If a customer goes to his bank and wants currency and the bank goes to the Reserve bank and asks for Reserve notes against this deposit—if the Reserve bank says "We cannot issue any, because we have not any gold to put up as collateral," you can imagine what

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would happen in the country. So this continuing of Government bonds as collateral in back of Federal Reserve notes is an absolute essential. The only alternative would be to dispense entirely with collateral back of Federal Reserve notes; but, as long as you are going to have collateral, the banks must be permitted to put up what they have to make up for the shortage of gold.

I will now take up the question of the reduction of the reserve ratio.

Conditions arising out of the war have caused the reserve ratio of Federal Reserve banks to decline from 91 percent at the end of 1941, soon after our entry into the war, to 49 percent at the end of 1944. If developments continue at the rate of recent months the ratio will fall almost to the legal minimum by the end of the present calendar year. If gold export or currency withdrawals or both should be greater than in 1944, the legal minimum will be reached sooner. The following table shows the factors in the situation, together with hypothetical projections through 1945 based on probable trends of currency, deposit, and gold movements.

Federal Reserve bank	Dec. 31, 1941	Dec. 31, 1944	Projections	
			June 30, 1945	Dec. 31, 1945
	In billions of dollars			
Reserves	20.8	18.7	18.2	17.7
Deposits	14.7	16.4	17.4	18.4
Federal Reserve notes outstanding	8.2	21.7	23.7	26.7
Liabilities requiring reserves	22.9	38.1	41.1	45.1
	Percent			
Reserve ratio	90.8	49.0	44.3	39.2

You will note from that table that, going back to December 1941, the reserve at that point, that is, the amount of gold, was 20.8 billion dollars. You will notice how that has declined until the end of last year it was 18.7 billion dollars, or we had lost 2 billion of gold reserve since 1941.

Mr. GAMBLE. Three billion?

Mr. ECCLES. No; 20.8 billion to 18.7 billion. That is as of the end of 1944. At the present time, at the end of this year, at the rate at which gold has been lost, projecting that through to the end of the year, we estimate that at the end of 1945 the gold reserve would be down to 17.7 billion dollars. It could be lower, or could be higher; we have to make hypothetical projections.

The deposits in the Reserve banks were 14.7 billion in 1941. Those deposits had gone up to 16.4 billion in 1944. The reason they have gone up, of course, is that the reserve requirements of member banks have increased, and, in addition, foreign deposits in the Reserve banks have grown. In 1941, the member banks were carrying about 3 billion of excess reserves. At the present time, they are getting along on around about 1 billion. They operate very closely and they

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do not carry any volume of excess at all. Their reserves are invested. As deposits in member banks go up, then their reserve requirements go up and, as the reserve requirements go up, their balances with Federal Reserve banks have to go up. And as their balances with the Federal Reserve banks go up, the Federal Reserve requirements of gold likewise go up, the ratio goes down. Coming to the end of the year 1945, we estimated that deposits would be 18.4 billion.

Federal Reserve notes outstanding have gone up from 8.2 billion in 1941 to 21.7 billion at the end of 1944 and, at the present rate of expansion, they are projected to 26.7 billion by the end of the year 1945.

That will give you the picture. You will notice that the liabilities at the end of the year, deposit and note liabilities requiring reserves, will be 45.1 billion; the gold would be 17.7 billion; and the ratio would be about 39 percent on a basis of these hypothetical projections.

Now, this chart [exhibiting] will give you a little clearer picture of those figures. You note here, going back to 1941, when it was 8.2 billion, as you will see on the chart, of Federal Reserve notes outstanding, and here [indicating] is where they have gone in 1944 and here is where we project them to the end of the year—up to 26.7 billion.

Mr. Smith. That is by the end of 1945, is it not?

Mr. Eccles. Yes; 1945—26.7 billion. At the present time, they are here, 21.7 billion, and that [indicating] is where we expect the Federal Reserve notes will go—26.7 billion.

Now, on the deposits, which is the other item requiring reserves, you will notice that is around the 16-billion-dollar figure here and is estimated to go up to 18 billion at the end of 1945. So that as the two items requiring reserves go up, naturally the reserve requirements will go up and, along with that, we get the gold, which is the reserve that we use for meeting reserve requirements going down and, naturally, this [indicating] is what happens to the ratio. The ratio up here [indicating] was very high, up to 91 percent and you will note it drops down to here, whereas the requirements will go up here [indicating].

That gives you an idea of the trend and why we are coming before you at this time for a change of the legislative requirements.

It will be seen that the decline in the reserve ratio has been due to a reduction in Federal Reserve bank reserves and to increases in Federal Reserve note and deposit liabilities. Reduction of reserves has reflected the fact that most of this country's exports have been on lend-lease, while our imports have been on a cash basis. Countries that have sold commodities to the United States have not been able to buy goods here, on account of war restrictions, and have either withdrawn or earmarked gold against the time when goods will once more be available for sale.

Growth of Federal Reserve note circulation has been a part of the general expansion of currency which has accompanied war activity in every country in the world. Expansion of both notes and deposits has reflected growth of Government war expenditures, enlargement of national money income, and advancement of pay rolls and trade at higher prices. So long as the Federal Reserve banks continue to do their part, as they surely must, to assist the Treasury in Govern-

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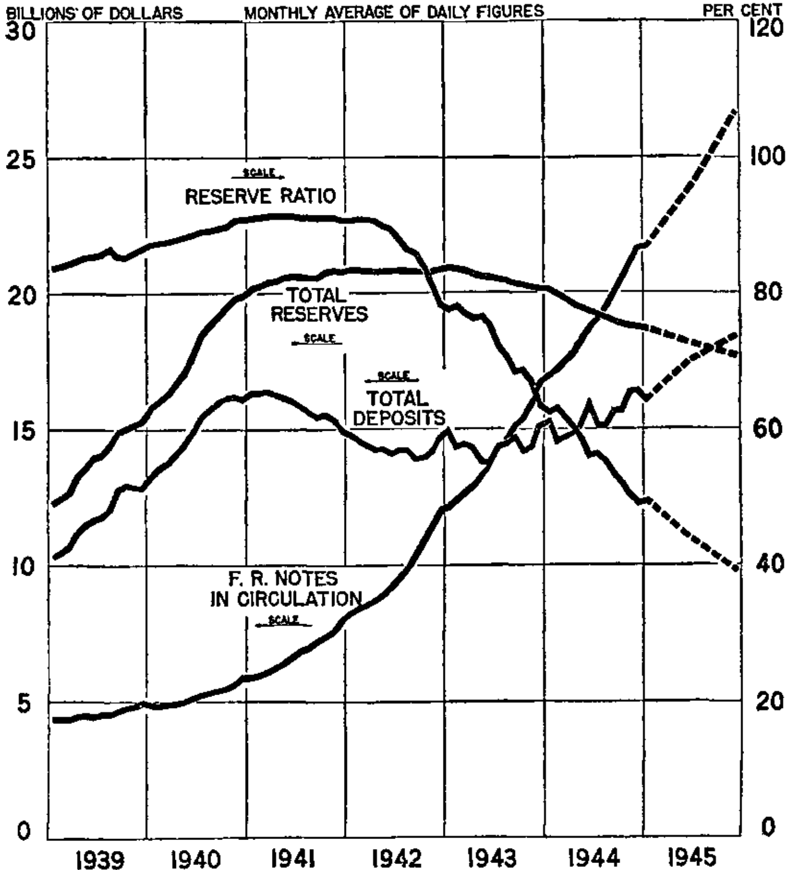
CHART 2



ment financing and in maintaining stable conditions in the market for United States Government securities, these banks must not be restricted by an arbitrary reserve ratio.

While the reserve ratio for all the Federal Reserve banks combined is at present still nearly 49 percent, that is, considerably above the legal minimum, individual Reserve banks have ratios that are much nearer to the low point required by law. A table is attached showing the reserve position of individual Reserve banks at selected typical dates. While adjustment in individual bank ratios is made periodically by changing their participation in the System holdings of United States Government securities, this involves a great deal of unnecessary work in practical operation. Since it is apparent

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that means must be found to handle the ratio problem, it is highly desirable that action be taken promptly. This would not only allay fears and uncertainties among holders and prospective purchasers of United States Government securities, but would also eliminate the necessity of making frequent and complicated adjustments among the Reserve banks.

There are several ways to meet the situation, all of which have been carefully considered. One way would be to issue Federal Reserve bank notes, which require no reserves, in place of Federal Reserve notes; another way would be suspension of reserve requirements by the Board of Governors of the Federal Reserve System, which is authorized by law, and a third way would be a reduction of reserve requirements by the Congress. Other devices, such as issuance of currency by the Treasury, or reduction of member bank reserve requirements, have been reviewed and found to be inadequate or inappropriate. Reduction of the ratio by law, which is proposed in the bill, is the most clear-cut method, as well as the most consistent with the responsibility of the Congress to regulate the country's monetary policy.

Issue of Federal Reserve bank notes in their present form was authorized by the Emergency Banking Act of March 1933, (you remember that was at the time of the bank holiday) and the authority will expire when the President declares that the emergency is over, which he has not done.

Reserve ratio of each Federal Reserve bank on the 15th of the month from July 1944 to February 1945

[Percent]

Federal Reserve bank	July 1944	October 1944	January 1945	February 1945
Boston	53.8	43.6	45.4	45.8
New York	50.6	46.4	52.8	50.7
Philadelphia	48.8	48.6	43.8	44.4
Cleveland	52.9	43.3	45.3	43.6
Richmond	57.5	47.6	45.6	46.6
Atlanta	57.0	51.7	52.0	52.1
Chicago	64.7	63.6	49.7	51.7
St. Louis	54.2	58.0	43.3	46.5
Minneapolis	49.6	51.5	44.9	44.8
Kansas City	53.2	45.7	45.0	45.9
Dallas	51.1	46.6	45.5	44.1
San Francisco	66.5	63.8	54.2	51.3
Total	56.0	52.0	49.3	48.8

I would like to go back to the variation in reserve ratios. You will notice these varied ratios. Here is Cleveland with 43.6 percent whereas, at that particular date, Atlanta had 52.1 percent. I do not know what the ratios would be if we did not shift back and forth between the banks to keep the reserves balanced out; I do not know whether any of them would have gone below the legal limit, or not. But, you see, as a practical matter, it is impossible to let the ratio fall to the legal minimum of 35 percent against deposits and 40 percent against notes for the system as a whole without having some banks fall below the legal ratio. You just cannot get that close to it; it would be a physical impossibility as a matter of practical operation. The Open Market Committee simply could not carry out its operation

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of buying and selling large quantities of Governments in the market, which is a necessity as a matter of market stability and Treasury financing, if you get too close to the line of reserve requirements. And there is also the question on the part of purchasers of Government securities—banks, insurance companies, and others who are thoroughly familiar with this operation and mechanism—that if it is getting close to the line and Congress has failed to give the Reserve Board power, then the question is immediately going to be raised in their minds, Is the market in Governments going to drop and the interest rate go up and should we sell; will the Federal Reserve have the power to manage this market any longer? And the question immediately arises as to the future of the interest rate on Government securities and you could get a very unsound and chaotic situation in your market. And today with the operation going as smoothly as it is and no question as to the ability to finance the war at the going interest rates, and no question as to the stability of the Government market, there should be no question left in the minds of purchasers of Government securities as their stability and as to the ability of the central banking system to manage that market. And if the reserve is allowed to get too close to the legal limit, that question is surely to arise. That is why we are coming to the Congress at this time, prior to the next war loan drive, so as to leave no question in the minds of Government bond purchasers, particularly financial institutions, as to the stability of the market.

To repeat: Issue of Federal Reserve bank notes in their present form was authorized by the Emergency Banking Act of March 1933, and the authority will expire when the President declares that the emergency is over. The need for the lower ratio may continue beyond that date. Furthermore, the difference between Federal Reserve notes and Federal Reserve bank notes gives rise to misunderstanding, and it would be simpler and less confusing to the public if Federal Reserve currency were all of one kind. It would be best at a time like this to have a Federal Reserve ratio that indicated to the Congress and to the people the amount of gold certificates held by the Reserve banks against their total deposit and note liabilities of all kinds.

The authority in section 11 (c) of the Federal Reserve Act to suspend reserve requirements does not appear to be the best method of meeting the situation, because the power was not designed for a situation like the present which is of indefinite duration. Suspension must be for a period not to exceed 30 days, renewable at intervals of 15 days. It also requires a penalty in the form of a progressive interest rate, to be determined by the Board, and added to the discount rate of the Federal Reserve banks. At a time like the present, when discount rate charges must fit into the general rate policy adopted for war financing, this would not be the best procedure.

Consequently the bill provides for a direct reduction of the required ratio. Such an action would be entirely consistent with the changes in conditions which have occurred since the ratio was first established by the Congress. The original purposes of the ratio were (1) to assure adequate resources for the Reserve banks to meet demands for gold or lawful money by depositors and note holders, (2) to limit the expansion of Federal Reserve bank credit, and (3) to

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assure the public that there was at least 40 percent in gold back of the Federal Reserve notes which were then being introduced for the first time.

The first purpose is no longer compelling since gold redemption is now not permitted for domestic use, and gold can be exported only under license. While the country's aggregate gold reserves are ample to meet any conceivable foreign demand, a reserve ratio high enough to meet possible demands for both domestic and foreign use is no longer appropriate under present conditions. The second purpose—limitation of Federal Reserve bank expansion—is not relevant at a time when expansion by the Reserve banks is essential to the needs of war finance. Thirdly, confidence in Federal Reserve notes is well established, and whether the amount of gold back of the notes is 40 percent or 25 percent makes no practical difference.

I might point out that silver certificates are accepted as freely as Federal Reserve notes; I also might point out that the old Civil War greenbacks issued, I think, during the Civil War, also are accepted as freely, and also state that the last Federal Reserve bank notes that have been issued, which have no reserve in back of them, are accepted freely. So the public does not discriminate between those notes with a gold reserve in back of them and those without.

Mr. SMITH. But there is a difference between them, is there not?

Mr. ECCLES. Not in the public mind. They accept them as freely. I am not talking about the difference, I am saying that whether they have a gold backing of 40 percent or 25 percent would make no practical difference in their acceptance as currency and I also want to say that the fact that some currency had no gold backing at all seems to make no practical difference.

War conditions have caused all belligerents to reduce or abolish central bank reserve requirements. I want you to get that point: War conditions have caused all belligerents to reduce or abolish central bank reserve requirements. The Bank of England and the Bank of Canada have no collateral in back of their notes; they have no gold reserve requirements at all either in back of the notes or deposits.

Mr. WOLCOTT. What about Russia.

Mr. ECCLES. Russia has a gold reserve of 25 percent back of their currency, but their currency has not expanded like ours. Russia deals on a pay-as-you-go basis. She has practically paid for the war as she has gone along and she has not had the great expansion in currency. She has a 25-percent gold reserve in back of her currency and I think she has no gold in back of deposits. And she has that gold backing because she has the gold and it was a requirement that existed under the old Czarist regime and under the present Soviet regime, and apparently they saw no point in changing it as long as they had the gold, and the fact that they recognized the gold reserve did not do any harm in maintaining the market for gold outside of Russia. Russia was much more interested in marketing her surplus gold outside than she was in maintaining it as collateral in back of her currency, and the fact that she continued to reserve it in back of her currency did help in recognizing the fact that gold has a value in the settlement of international balances.

Miss SUMNER. Is it not a fact that nobody knows how much gold Russia today has?

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Mr. ECCLES. That is correct; nobody knows. We do know she has 25 percent in back of her currency; at least the Russians who were over here at Bretton Woods told me that they maintain a 25 percent reserve. How much more than that they have, I do not know. But I am sure they do not maintain it in back of their currency in order to maintain confidence among her population in her currency and, if she had occasion to use the gold for other purposes, there would be no hesitancy in their using it.

Mr. TALLE. Did the price offered for gold by our country have something to do with that action?

Mr. ECCLES. You mean the maintaining of the gold reserve in back of her currency?

Mr. TALLE. As I recall it, you said they were willing to export it.

Mr. ECCLES. Yes.

Mr. TALLE. Rather than to keep it in back of their currency.

Mr. ECCLES. Well, they hold it in back of their currency; they have not exported what they hold in back of the currency. They hold gold in back of the currency at 25 percent, but they have exported a lot of gold, of course. They have not accumulated a lot of gold.

Mr. TALLE. The encouragement to that export was perhaps given by the high price offered for gold in our country?

Mr. ECCLES. Well, there is no question but what Russia was glad to get as high a price for her gold as anybody would be willing to pay her, because it gave her foreign exchange with which to buy what she wanted. That is perfectly true. But even though we had not increased the price of our gold, I think she would still have exported gold, because she would not accumulate gold; she had no use for it. She would prefer to export it to get the things she needed and the higher the price naturally the greater the pressure to produce gold and export it if you need goods.

War conditions have caused all belligerents to reduce or abolish central bank reserve requirements. Mechanical limitations on the ability of a central banking organization to extend credit must inevitably give way in time of war to the paramount obligation to support the war effort.

A reduction to 25 percent is proposed because it would be sufficient for all foreseeable contingencies. It would enable the Reserve banks to meet such additional demands for currency by the public and for reserve balances by member banks as are likely to occur. The currency supply and the bank deposit structure could nearly double before the legal minimum would be reached.

The bill provides for elimination of the distinction made in the present law between reserves required against notes and against deposits both as to percentage and as to composition of the reserves. Since the two liabilities are interconvertible at the option of the owners, the same requirements should apply to both. The provision in the bill that legal reserves should consist only of gold certificates would also eliminate controversy as to what constitutes lawful money, and whether the Federal Reserve banks could, if so minded, use their own notes (Federal Reserve notes or Federal Reserve bank notes) as reserves against their own deposits.

A clean-cut uniform requirement of gold certificate reserves of 25 percent against both notes and deposits appears to be the best solution of the problem.

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In conformity with the proposed reduction of the ratio to 25 percent the bill decreases proportionately the levels of the ratio at which the imposition of the different penalty rates provided in the law when reserves are suspended would be prescribed.

I might say that different provisions of this legislation have been discussed over the past year a good deal with the Board—Federal Reserve Board—and its staff, and also have been the matter of discussion with all of the Federal Reserve bank presidents in the conference we have had with a meeting of the Open Market Committee, and we have also discussed the matter with the Treasury, and there is a unanimity in agreement that this is the best way to meet the situation. We all thought that it would be best to come before the Congress and ask them to reduce the gold reserve requirement rather than to issue currency, which we could do—we could have issued Federal Reserve bank notes in indefinite amounts and it was admitted that that was undesirable, that the Congress passed that bill for another purpose and we felt it should not be used for this purpose.

There have been some suggestions since the bill was introduced, among some of the bankers, that inasmuch as this legislation—the proposal in this bill—would give to the Federal Reserve System all the power that is conceivably necessary to meet any expansion of the currency that may be required that the power to issue Federal Reserve bank notes might be repealed at this time, and likewise the power to issue notes under the Thomas amendment, the $3,000,000,000 authority to issue notes; that was a broadening of the power here, and that was the continuation of the power to issue currency under the Thomas amendment which was passed, I think in 1933, and the authority of the Board to authorize the issuance of Federal Reserve bank notes would be unnecessary and therefore should be repealed.

I have told the bankers that so far as the Federal Reserve is concerned there could be no objection to repeal of those two provisions; that I saw no harm certainly in their repeal; after 12 years they have not been used when the expansion of Federal Reserve notes has occurred and I can see no danger of that authority being used; I saw no need for the authority, and therefore if it was repealed I could not see any objection unless it be that when you start to amend a bill there is always the question of how far you are going, because one amendment calls for another and the first thing you know you have gotten into very controversial matters; that this bill at the present time is, I think, about as uncontroversial as most any bill that has been considered before this committee, and if the amendment proposed upon it induced the offering of further amendments then I would think it was unfortunate; if on the other hand it did not, I could see no objection to the proposal.

I merely wanted to make that statement here because, no doubt, you may be hearing from the bankers and the suggestion may be made that the bill be amended to provide for the elimination of the authority that now exists to issue the other notes.

Mr. Chairman, I think I have said about all I have to say on the subject.

The Chairman. Mr. Eccles, how much commercial paper does the Federal Reserve own?

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Mr. Eccles. At the present time?

The Chairman. Yes.

Mr. Eccles. We have no way of getting commercial paper except from member banks by discount. And, the banks do not like to do that; the member banks will sell Government bonds rather than sell their paper. They have so many Government bonds today; about three-quarters of all of their assets consist of Government securities and, when they need funds today to meet a withdrawal of deposits, they merely sell their Government bonds to provide the reserve they need.

The Federal Reserve buys those Government bonds if there is not an immediate market for them. So, there has been very little borrowing from the Reserve System since 1929. There has been a diminishing amount of what is known as commercial paper since the last war. By the end of the twenties the issuance of commercial paper had largely disappeared. The working capital of business grew very rapidly during the twenties; they did not need to borrow, and they sold their securities, they sold their stocks in the market and raised money at a time when there was an excellent market for stocks at a very high price; they got money very cheaply, and a great deal of it during the twenties, and as you recall, corporations were replenishing their cash requirements, and were getting out of the borrowing class. So that the whole structure has completely changed, the whole financing structure, since the Federal Reserve was organized in 1913.

Mr. Monroney. Will you put in the record a statement showing the amount of paper that was put out, commercial paper, since 1930, so we can have some figures in the record?

Mr. Eccles. The amount of borrowings from the Reserve System, on commercial paper?

Mr. Monroney. On commercial paper; yes.

Mr. Eccles. Yes; we can do that. It is practically nil.

Mr. Monroney. Was not that one of the original purposes of the Federal Reserve System, to give us an elastic currency and expand the credit opportunities of business?

Mr. Eccles. You have got an elastic currency now through Government bond operations.

Mr. Monroney. Yes; but that does not help the individual businessman.

Mr. Eccles. Oh, yes; it helps him because he can go to the bank and borrow what he wants; the borrowing bank can put up paper if it wants to, but it no longer does that; it takes its Government bonds instead and sells these Government bonds and gets all the money it needs to make the loan to its customers, so that the individual borrower is in no way hampered. The banks will make loans now as willingly as at any time in the past—I mean, with greater freedom than at any time in the past; the banks are able to make the loans without going to the Federal Reserve banks with their customers' paper. With the banks full of bonds, about three-quarters of their earning assets in Governments, when a customer wants to borrow money the banks are willing to sell the Government bonds and make the loans if they do not have sufficient cash available otherwise.

Another thing they are doing is that business, like individuals, has been paying its debt at an increasing scale.

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And as you increase credit the most of that money goes to the Government. The individuals are paying their debts. As the Government borrows the money the money goes into circulation, the individuals and corporations, as they get that, are paying their debts.

Mr. KUNKEL. How much money is there in circulation now?

Mr. ECCLES. About $26,000,000,000.

Mr. KUNKEL. Just in the vaults and in the tills?

Mr. ECCLES. There is very little in the vaults of the banks.

Mr. KUNKEL. I mean, that is in the hands of individuals; you do not have it in banks——

Mr. ECCLES. That is what we call money in circulation; yes.

Mr. KUNKEL. Floating money.

Mr. ECCLES. That is right.

Mr. CRAWFORD. Mr. Chairman, there is one point Mr. Eccles made with reference to the suggestion of Mr. Monroney: I think the last figures of the Securities Exchange Commission show that corporations alone have approximately $45,000,000,000 of what might be called working capital, and naturally they do not want to borrow any money from the Government.

Mr. ECCLES. The corporations, all of the corporations, including insurance companies in 3 years, have increased the amount of cash and Government bonds from $28,000,000,000 to $63,000,000,000. The latest figures we could get were as of last October, and commencing with the end of 1941 and up to the date of the last figure we could get for 1944, showed that corporations' cash and Government bonds had increased from $28,000,000,000 to $63,000,000,000.

Mr. CRAWFORD. There would have to be set off against that their increased liability which must be met out of the cash and bond and other liquid assets.

Mr. ECCLES. That would leave above $40,000,000,000 of working capital.

Mr. CRAWFORD. By about $40,000,000,000.

Mr. ECCLES. Yes.

Mr. CRAWFORD. Therefore there is no demand on their part against the banks for loans and as a consequence you say, they have got so much working capital on hand.

Mr. ECCLES. That is right.

Mr. CRAWFORD. And the banks have no commercial paper of consequence because of that.

Mr. ECCLES. That is right.

Mr. CRAWFORD. With which to borrow on.

Mr. ECCLES. That is true with business as a whole.

Mr. CRAWFORD. Yes.

Mr. ECCLES. Of course, there are a comparatively small number, (that is, small by comparison with the aggregate of business concerns) that have gone into war production and have secured volume all out of proportion to any capital that they had and they have had to have, of course, a great deal of help from the Government. In many instances the Defense Plant or the Army or the Navy or the Maritime Commission have provided them with their machinery and facilities; they have had the know-how, got the contracts, and have done a good job at first and have expanded and expanded and expanded. Then they have gotten working capital from the banks under the Federal Reserve V-loan program which is concerned with the production

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program, and which has run up until there are several billion dollars of guaranteed capital.

Mr. MONRONEY. Do you have information showing the authorization and the commitments involved in the V-loans that you can supply for the record?

Mr. ECCLES. We could find out what is the amount of the outstanding V-loans and what the commitments are.

Mr. MONRONEY. Can you give that by dollars, showing just how much of it is being used?

Mr. ECCLES. Yes.

(The information requested above will be found on p. 70.)

Mr. MONRONEY. As I recall, it was almost 50 percent for commitments the last time I checked.

Mr. ECCLES. That would be good information in connection with the 13 B bill that would guarantee all the loans to industry, known as the Wagner-Spence bill. We will be glad to get that information, Congressman.

Mr. CRAWFORD. May I ask you a further question with reference to the Government-owned securities. Can you give us the average rate of interest which the banks are now receiving on Government issues which they hold?

Mr. ECCLES. That would be pretty difficult to say.

Mr. CRAWFORD. Would you care to make an estimate?

Mr. ECCLES. We can make an estimate of it.

Mr. CRAWFORD. I think that would be good information for the record.

Mr. ECCLES. The ratio is about 1.5 percent.

Mr. CRAWFORD. What is the average rate of interest on the total debt outstanding; about 1.9 percent?

Mr. ECCLES. Yes.

Mr. CRAWFORD. Very well; you were speaking about the rate of interest awhile ago——

Mr. ECCLES (interposing). I might say this: That the rate of interest is going down and it is going down for the reason that as the pre-war debt falls due it is being redeemed, of course. The 4¼, 4, and 3¾ percent bonds that were issued in the 1920's are being refunded, of course. The interest will be reduced because of the high rate on securities being redeemed. The securities that were issued in 1933, 1934, and 1935 and along in that period had rates as high as 3¼, 3, and 2¾ percent, and these bonds will certainly never be refunded at any such rate.

Mr. CRAWFORD. In addition to this declining interest rate in refunded issues the present new war issues which we are putting out, like the Fifth, Sixth, and perhaps the Seventh War Loan drives, the rates are being lowered each time, are they not?

Mr. ECCLES. Not the true investor rates, such as the E bonds.

Mr. CRAWFORD. That is my understanding.

Mr. ECCLES. That is, the popular bonds sold to the rank and file of people.

Mr. CRAWFORD. What about the short-term paper?

Mr. ECCLES. Yes; I was coming to that. The E, F, and G's, the rate remains the same; and that has been true also of the bonds issued at 2½ percent, and the 2¼ percent bonds. They are marketable bonds but are not eligible for banks.

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Mr. CRAWFORD. I am directing my remarks primarily to the bonds which the bank holds, the interest rates on those are being reduced from time to time?

Mr. ECCLES. The rates are being largely reduced by the banks themselves; the banks drive those rates down in the price which they bid.

Mr. CRAWFORD. In other words, they bid at a higher price.

Mr. ECCLES. They go from short into long term bonds wherever they are available. Whenever the Treasury issues a 2 percent bond, even where the banks cannot buy them direct, they become very large holders of those bonds, because of what we term the free riders, who speculate and secure a large number of these issues and immediately turn the bonds over to the bank at a premium.

Mr. CRAWFORD. On that particular point: What was the approximate increase in the total volume of Governments in the bank portfolios between the beginning of the last drive and the close of that drive?

Mr. ECCLES. Do you mean the increase in volume between the fifth and sixth drives?

Mr. CRAWFORD. No. Let me restate that question, because I want to make it very clear. What was the increase in volume of Government issues in bank portfolios between the date of the beginning of the Sixth War Loan drive and the estimated goal of that drive. During that period there were no offers made to banks, and the figure I am asking for now is——

Mr. ECCLES (interposing). I think we can give that to you approximately. It is estimated that out of the 22 billion, that was, of securities, that were supposed to be sold to the public in that period of time, the banks wound up with around $9,000,000,000, so that the real sale to the public was not anything like what it was supposed to be.

Of course the banks did not get the securities directly, they were sold to the public during the drive. What happened is that the corporations and others sold the securities they had bought during prior drives to the banks, and the corporations in turn bought the securities that were offered in the new drive. So that the banks furnished the money, possibly 9 billion of the 22 billion dollars that was subscribed, by taking the securities that were held by the individuals and corporations so they could subscribe, and take them at a profit, or take the securities that were subscribed by the individuals and corporations during the drive immediately after they were received by the subscriber.

Mr. CRAWFORD. Roughly about 40 percent of the $21,000,000,000 went into bank hands?

Mr. ECCLES. Well, of course, that is what has happened from the very beginning. In other words, the cost of the war is about $100,000,000,000 roughly, we will say, the cost of the Government, including the war and other objectives, is about 100 billion a year. Of that amount we estimate that about $45,000,000,000 is being paid as we go, out of taxes. That leaves $55,000,000,000 of what we are spending to get what we need. We are not paying for it as we go at all and we are borrowing, by increasing the public debt, and as we borrow about 60 percent of what we borrow is borrowed from individuals and corporations out of the income that they do not spend. In other words, that much of the Government's spending that they get directly and indirectly they do not spend but put 60 percent of this debt deficiency into Government securities.

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Now the balance, which is 40 percent, or thereabouts of the amount, the banks take right along and that runs around 24 or 25 billion a year. That is what they have taken for going on a year—they did it in 1943, they did it in 1944, and there is every possibility they will do the same thing in 1945; that is about the pattern.

Mr. CRAWFORD. If the banks proceed to borrow—I mean commercial banks proceed to borrow from the Federal Reserve instead of selling these bonds as they now do, about what rate of interest would they have to pay?

Mr. ECCLES. One percent.

Mr. CRAWFORD. One percent?

Mr. ECCLES. Or a half of 1 percent, if it was secured by less-than-a-year paper; for longer maturities than that 1 percent is the discount rate.

Mr. CRAWFORD. And in order to avoid the necessity of borrowing and paying them less—well, we will say from three-eighths of 1 percent up to 1 percent?

Mr. ECCLES. There are only two issues of less than 1 percent; one of those is known as the Treasury 90-day bill at three-eighths of 1 percent, and we hold a large amount of them.

And of the $19,000,000,000 held by the Federal Reserve about $12,000,000,000 we provide through purchase of bills.

The other type of issues are the certificates known as the seven-eighth one-year Treasury certificates. Now, the banks could borrow at one-half of 1 percent on certificates which give them seven-eighths percent. However, they are unwilling to do that because there are very few banks willing to show any borrowed money in their financial statement. They have a fear of doing that. The experience at the time of the bank collapses in 1929–33, show that the banks that showed borrowed money were the ones that had the runs and the ones that closed up shop and they have not gotten over the experience they had. Therefore borrowing from the Reserve System is a very unpopular custom with the banking system these days.

Mr. CRAWFORD. It makes a more acceptable statement to the public for the banks not to show any borrowed money.

Mr. ECCLES. The banks think that is correct.

Mr. CRAWFORD. I can understand that.

Now going to the table at the bottom of page 3 of your statement: "Projections" under June 30, 1945, and December 31, 1945, reduction of reserve ratio. Has the outgo incident to the Bretton Woods proposal been considered in those figures?

Mr. ECCLES. No. You mean——

Mr. CRAWFORD. Has the disgorged gold affected that column?

Mr. ECCLES. No; it will not affect it because the gold proposal at Bretton Woods refers to the $1,800,000,000——

Mr. CRAWFORD. That is about it.

Mr. ECCLES (continuing). From the stabilization fund, does it not?

Mr. CRAWFORD. What about this figure?

Mr. ECCLES. And it has never been a part of this.

Mr. CRAWFORD. Not in the reserve?

Mr. ECCLES. Never has been.

Mr. CRAWFORD. So you can remove that entirely from the discussion.

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Mr. Eccles. That is right.

Mr. Crawford. In the program as outlined or set up according to your present concept, that gold, other than the stabilization fund, $1,800,000,000, will not be required; is that right?

Mr. Eccles. That is right.

Mr. Crawford. Let me go a little further and ask you about the stabilization fund: Does the present concept of the International Bank consider the disgorging of any of that gold?

Mr. Eccles. I think a very small amount; it is only about 2 percent of the subscription which will mean about $60,000,000.

Mr. Crawford. About $60,000,000?

Mr. Eccles. That is right.

Mr. Crawford. On your distribution in the projection there is taken into consideration the advance in distribution incident to Government financing, I suppose?

Mr. Eccles. That is correct.

Mr. Crawford. Of course the Federal Reserve account is on a good curve there and that explains that table.

Now one or two other questions: At the present time you can issue all the Federal Reserve bank notes you want to; there is no prohibition against the issuance of Federal Reserve bank notes, is there?

Mr. Eccles. That is right.

Mr. Crawford. As a result of the changes we have made in legislation in the last 10 years.

Mr. Eccles. That is right.

Mr. Crawford. Mr. Wolcott suggests the question whether there is any directive against issuing them.

Mr. Eccles. No; there is not.

Mr. Crawford. There has been no such directive?

Mr. Eccles. That is right; there is no directive against such issues.

Mr. Crawford. So that the Federal Reserve can proceed to issue them—when a company puts up collateral to the bank and it in turn takes the commercial paper and rediscounts it, you can issue the Federal Reserve bank notes as heretofore?

Mr. Eccles. That is right.

Mr. Crawford. That clears up that point.

Now one more question on this matter of interest: Is there some difficulty being incurred at the present time due to the market value of Government issues tending to advance in anticipation of further reduction in the interest rate?

Mr. Eccles. Well, I think the Government issues are tending to advance where their market issues are eligible for bank investment because there has been an indication by the Treasury that it does not expect to issue 2 percent bonds, that what will be made available to the banks will likely be securities of a lower yield and that has, of course, induced the banks to sell their short-term securities to meet the reserve requirements, and to buy—to sell short securities and buy long securities.

Between war loan drives the banks have been losing reserves and will continue to lose reserves as fast as their war loan accounts are drawn down. This is because war loan deposit accounts are not subject to reserve requirements.

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As the Government spends that money and the money goes back into the banking system and into the hands of depositors, individuals and corporations, it becomes subject to reserve requirements. In order for the banks to meet those requirements they have to sell their securities which they bought during the war loan drive, and in spite of the fact that they have to sell securities on balance, after drives they have bought on balance during the drive. The Federal Reserve will buy, we estimate, about three and one-half billion dollars in securities between the sixth drive and the seventh drive to take care of the increased reserve requirements of the member banks and to take care of the expansion of currency. If the present trend continues the commercial banks will buy on balance a substantial amount of bonds, long-term notes, and sell bills and certificates to a sufficient extent to provide the reserve that they need, and at the same time to enable them to buy more longer-term securities.

Of course, if the Treasury was willing to supply the banks with all the 2 percent bonds they wanted, just give them an open door and say, take all you want, what would happen would be of course that the 2-percent bonds would not go up to these premiums, but you would find the amount of the short-term Treasury financing reduced and the amount of long-terms increased; you would find a much larger percentage of public debt in long-term higher rate securities and a small amount of the public debt in short-term securities.

In my opinion that would be against the public interest because that would increase greatly the earnings of banks which are already very substantial; that would increase the interest cost to the Government while the interest of the Government and the public generally is to keep the interest cost down as much as possible, keep the bank earnings down to a reasonable amount and to accomplish that it is necessary to meet more of the public debt in short-term low-interest ranges and less of it in the longer term ranges which are eligible for banks.

Mr. CRAWFORD. May I ask you a question right there?

Mr. ECCLES. Yes.

Mr. CRAWFORD. If the public debt—the funded debt is about how much?

Mr. ECCLES. It is about 230.

Mr. CRAWFORD. About $230,000,000,000. What proportion of that consists of savings and borrowings which can be matured at any time, we will say, within 60 days after acquisition by the owner, plus certificates, plus bills, plus notes, and plus the 1 and 1½ percent, we will say, of short-terms? The sum of all those I have just enumerated deducted from the $240,000,000,000 leaves how much at the present time of long-term paper?

Mr. ECCLES. I do not know; I was not thinking of savings bonds, so much as marketable paper.

Mr. CRAWFORD. I think you will find, if you will check the figures, that it will run about 118 billion out of the 230 billion.

Now one further observation: In every drive that has been made since the war started, and even going back prior to the war, it seems that in order to sell these bonds the seller has emphasized the thought in the mind of the purchaser that he can buy the bonds and when the war is over he can cash them in and buy some goods.

Mr. ECCLES. I think that is a mistake.

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Mr. CRAWFORD. I think it is a tragedy.

Mr. ECCLES. It is a mistake to advocate that.

Mr. CRAWFORD. Here are $40,000,000,000 of these savings bonds in the hands of people which they may proceed to cash very rapidly when the war is over, and when the emotional appeal is gone and we start to produce these goods, and at that time the public has stepped out of the market, we will say, and there is nobody to whom to sell these refunding issues so the Treasury will have the dollars to hand to these people.

At that time we will have an exceedingly large short-term obligation outstanding, probably 65, 75, or 90 billion dollars—perhaps as much as $90,000,000,000, and we might experience some bad moments; it would be better perhaps if we had some 25- and 50-year bonds instead of from 90 to 100 billion dollars of short terms.

Mr. ECCLES. I do not believe that will be true so long as it is done by the banking system. I think it is unfortunate that we have so many high-rate, long-term bonds which are eligible for banks today.

Mr. CRAWFORD. I can appreciate your thought.

Mr. ECCLES. The bank holdings of Government securities are the equivalent of cash that the banks have, which are permitted to create the money that is needed to finance a deficit, and they should not be paid a return for that privilege in an amount that permits them to get exorbitant earnings. I think it is bad for the banking system, because sooner or later it will bring unfavorable public reaction, and I think so long as the banks are permitted to go into the higher-yield, long-term securities they are going to do so, because they now have such complete confidence that the market is going to be supported that they do not feel there should be a difference of 1⅛ percent between the seven-eighths 1-year certificates and the 8- to 10-year 2-percent bonds. The net result is they go more and more into long-term, and they bid the price up until the 2-percent bonds are now yielding only about 1¾ percent.

Mr. CRAWFORD. In other words they drive the price up to that point. I appreciate what you say.

Mr. ECCLES. Now answering your question about the savings bonds, I do not believe that the public is going to cash in the savings bonds to any extent, enough to unbalance the holdings, if we can hold the price structure and prevent the inflationary trend so they will feel that the purchasing power of the bonds is there when they are ready to redeem them when they mature later on and that the purchasing power will not be greatly depreciated.

The important thing is to make the fellow who puts his money into these bonds realize that he will be able to buy as much at the later date as they will buy when they are issued. That is very, very important, and maybe with the right to convert the bonds into——

Mr. CRAWFORD (interposing). That would be particularly true if we had reasonably full employment.

Mr. ECCLES. That is right.

Mr. CRAWFORD. With a good standard wage and salaries being paid with which they can go out and buy the things they might need and not cash their bonds.

Mr. ECCLES. The bonds would act as a backlog of security for a long time and they should be willing to spend from their current

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income and not cash the bonds. People hesitate very much, who have made purchases, and acquired the bonds which are becoming more valuable as they get closer to the maturity date, in terms of higher interest rates, people hesitate to cash them, and as long as they have got confidence in the purchasing power one of the last things they will do is to cash these bonds and spend that money. That is why it is so terribly important to hold the line on inflation.

Now just one more word in connection with your question on the question of short-term debt: The percentage of outstanding public market debt—the percentage of short-term outstanding public loan debt in relation to the long-term debt has been decreasing recently. The reverse, in my opinion, should be true.

There is no reason to pay the corporations that are buying the public debt against taxes to be paid and against what they think is a rainy day reserve and against their inventories or depreciation reserve that they have not been able to spend because of manpower shortage and materials. They are interested in holding those securities only until such time as they can use the money in purchases, and they have got surplus money and they buy Government securities because they are pressed to do so during these drives.

Now they would buy securities just as readily at seven-eighths percent as they do at 2 percent; the short-term investment with them—there should be short-term rather than long-term.

The same thing is true, should be true, with commercial banks; there should be short-term investments, so that if deposits shrink, if a bank in a war area finds its deposits shrinking it will have liquidity to take care of that. They should not, in my opinion, be permitted to get the interest rate return that the further offering of 2-percent bonds to them would give because the earnings do not call for it.

Mr. Brown. I want to ask you a question, Mr. Eccles: Is it not true that the bonds issued during the First World War bear a much higher rate of interest than the bonds issued during World War No. 2?

Mr. Eccles. Oh, yes; they started to finance World War No. 1, I think, with bonds at 3½ percent, and 4 percent.

Mr. Brown. I would like you to place a statement in the record showing the average difference.

Mr. Eccles. And they were tax-free.

Mr. Crawford. Yes, they were tax-free.

Mr. Eccles. Computed interest rate on the debt: August 31, 1919, highest war debt, 4.196 percent, January 31, 1945, 1.924 percent.

Mr. Smith. Mr. Eccles, you made the statement a moment ago that—or confirmed a statement that was made by one of your associates—that the United States would pay only 2 percent of the subscriptions in gold into the International Bank. Is that the statement that was made?

Mr. Eccles. I understand that is right.

Mr. Smith. Our total liability would be, to that bank, $3,175,000,000; is that right?

Mr. Eccles. I could not tell you.

Mr. Smith. That is the figure that is given here in this schedule relating to that bank.

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Now, since our dollars are convertible into gold our total gold liability in this proposal could actually be $3,000,000,000, is that not correct?

Mr. ECCLES. I could not tell you. I am not an authority on that subject; I am discussing the bill here and not the Bretton Woods proposal which I do not feel that I am in a position to discuss.

Mr. SMITH. But, whatever our gold liability would be in the bank it would have a bearing upon the proposal before this committee to reduce the gold reserves, would it not?

Mr. ECCLES. Then if what you say is correct, of course the 25 percent—we probably should remove the gold reserve altogether in the Federal Reserve notes——

Mr. SMITH (interposing). In other words, you would reduce the reserve which protects the value of our money and pledge the $2,000,000,000 gold in the stabilization fund as a liability in the bank?

Mr. ECCLES. I do not think the gold—of course, we are protecting the value of our money——

Mr. SMITH (interposing). I did not understand you.

Mr. ECCLES. I do not feel that the gold is any protection to the value of our currency, Mr. Smith.

Mr. SMITH. Let me ask you this: What is the purpose of contributing gold to the international monetary fund but to protect the value of the foreign currency?

Mr. ECCLES. Gold, of course, is used in the settlement of international balances. So far as the domestic situation is concerned gold is not in circulation, it is not accepted in payment of currency, it does not circulate at all, and we are not—there is no more or less currency by reason of having the gold, and whether you have the gold back of it in no way is going to restrict the amount of currency.

Mr. SMITH. It does not affect it?

Mr. ECCLES. It is the public that determines the amount of currency in circulation.

Mr. SMITH. You say then that the gold which heretofore has been used for this purpose, has no relationship to currency?

Mr. ECCLES. That is it.

Mr. SMITH. Therefore you believe it makes no difference whether you have gold reserves or not?

Mr. ECCLES. That is right.

Mr. SMITH. That is right?

Mr. ECCLES. Yes.

Mr. SMITH. Now, it seems to make a great deal of difference to foreign countries who want the use of this gold in the international banking arrangement and monetary fund as to whether they have gold to support their own currencies or not.

I am glad you are frank about this thing and tell us you do not believe there is any relation between our gold and our currency. Of course, if there is not, I do not see any reason for asking that the reserves be reduced and the only answer or the only proposition you can make is that they ought to be wiped out.

Mr. ECCLES. Oh, I am perfectly willing to have them wiped out.

Mr. SMITH. All right.

Mr. ECCLES. But as long as we have the gold, I am like the Russions in that regard—so long as we have the gold, what objection is there? If people feel better about it, if they think in some way

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or other that it is sounder currency and the situation is better, why there is no point in arguing the issue with them. We have the gold and let us provide the reserve requirement so long as it can be met. I think a 25 percent gold requirement will meet the situation for a very substantial time—for a long time. And if it does meet it, then I see no good reason in getting opposition from those people who would feel better with a 25 percent gold backing than they would feel if they had no gold backing.

Mr. SMITH. In other words, you recognize that that psychology does exist?

Mr. ECCLES. Yes; I think it exists. It is not a question of logic; it is a question of emotion. And if they feel better by it, why the 25 percent we are talking about here is only a minimum and although the law now requires a 40-percent minimum in back of Federal Reserve notes and 35 percent in back of deposits, we have had as high, as I show here, as 91 percent and at one time we had 100 percent. So, should you put the minimum at 25 percent, as requested, it does not necessarily mean it will have to go to 25 percent. It may well be when the war will be over, that currency expansion will stop and it actually might decline. We are likely to see less currency, that is a possibility—that currency will come back as the war is over and gold will again start to flow in the country and the reserve ratio, instead of being 25 percent, may be 50 percent in the course of 2 or 3 years. That is certainly possible. The mere fact that we fix 25 percent means it only fixes the low point below which the ratio must not fall; but, if there is enough gold to give 50 percent backing, that is what you will have.

Certainly the Federal Reserve System does not put up eligible paper or Government bonds in back of Federal Reserve notes except to provide the deficiency in gold as a collateral. The gold first goes as far as it will go and the other merely makes up a deficiency.

Mr. SMITH. You mean by that, then, so far as your policy is concerned, you intend to hold this reserve ratio up as much as possible?

Mr. ECCLES. Well, there is nothing we can do about it. There is no policy we can pursue, at least, that in any way affects it. That is clear out of our range.

Mr. SMITH. You think it would be better if the reserve remained above 25 percent even if the minimum is fixed at that figure?

Mr. ECCLES. Personally, I would be indifferent to it. It would not make a particle of difference in the economic situation, or the monetary situation.

Mr. SMITH. Have you received any letters, Mr. Eccles, expressing fear about this proposed reduction in reserve requirements?

Mr. ECCLES. Amazingly, I have not received one.

Mr. SMITH. Well, I have.

Mr. ECCLES. Not one.

Mr. SMITH. I have, and now it appears to me we are giving an impression to the country that we are doing something here that is protecting the dollar. You would not agree that is the case, would you?

Mr. ECCLES. I certainly would not.

Mr. SMITH. You would not?

Mr. ECCLES. I certainly would not.

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Mr. SMITH. I think our people feel they would like to have the dollar protected. I would like to have the dollar protected, and I am just wondering whether you would object to taking the $2,000,000,000 gold stabilization fund that has been lying idle for all these years, and putting it into the reserve fund?

Mr. ECCLES. The only way you can do that is for the Government to spend the money.

Mr. GAMBLE. It is now planned to use it in the bill approving the Bretton Woods agreements.

Mr. SMITH. That has not been passed. It is proposed to put it into Bretton Woods International monetary Fund and use it to support the value of foreign currencies. I am proposing to abolish the $2,000,000,000 gold stabilization fund and adding that gold to our present gold reserves. Therefore, I have prepared a bill that I am introducing shortly to effect this purpose.

Mr. ECCLES. I do not believe the American people know anything about it or care at all about it one way or the other. In the first place, that $2,000,000,000 was created out of the process of raising the price of gold that we had. We merely said we would change the value of gold and created 2.8 billion merely by that act. And that $2,000,000,000 is the portion of it that has not yet been used.

Now, the way to protect the dollar is for the Congress to not appropriate more money than they are willing to raise by the levy of taxes. That is the only way and the gold has nothing to do with the protection. The protection is based upon avoiding expansion as a means of payment through deficit financing through the banking system, and that is the only way to keep the purchasing power of the dollar up. If you keep its purchasing power up, why you keep its value up.

I don't mean by that that I am against deficit financing and expansion as a means of payment when we have millions of unemployed people and idle production; but when you reach a condition of full employment and full utilization of your productive facilities, then merely to put more money in the hands of people when you cannot produce more goods is a measure that tends to devalue. That is the thing that may, by the expansion of the currency, decrease its purchasing power, unless we maintain prices, rationing, allocations, export licenses and the other necessary controls until such time as we are willing to get a balanced budget and until such time as we get full production and employment for civilian use.

Now, if we could convert, say, 40 percent or 45 percent of our total economy which is now engaged in war production to the production of things that the people want, then any backlog of buying power which now exists would be met within a period of a few years and your inflationary danger would be over. But when I think of the value of our currency, I cannot think of it in terms of gold; I can only think of it in terms of what the people want to buy. People do not want to convert their currency into gold; they want to convert their currency into food, clothing, housing, etc., and the value of their currency in their minds is determined by what it will buy and it has no relationship to gold. When gold was $21 an ounce, before we raised its price prices were much higher than they were when gold was $35 an ounce—which is a demonstration that the purchasing power of your currency has no relationship to its value in terms of gold.

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Miss SUMNER. Governor Eccles, I have seen several authorities on this and they have all said that nobody knows whether we are going to have inflation or deflation after the war. Opinions apparently differ widely. What is your opinion on that—if you do not mind telling us?

Mr. ECCLES. Whether we are going to have inflation or deflation?

Miss SUMNER. Whether we are going to have inflation or deflation after the war.

Mr. ECCLES. Well, that is a long subject. It depends on how long the war lasts, what the size of the deficits are, how willing we are to maintain all the necessary controls, how willing we are to levy the necessary taxes, how soon we reconvert and produce the necessary civilian goods, and how much we are going to let the rest of the world have. I mean it is all related to a lot of factors as to the extent to which you might have inflation. I do not think we have necessarily to have inflation; the means are at hand, if the Congress and the public are willing to accept the necessary means, to deal with that question.

Miss SUMNER. Do not you think we are in a peculiar situation when the war with Germany is about to end in 3 months and there is a complete difference of opinion as to whether we are going to have inflation or deflation—which are two completely opposite economic conditions?

Mr. ECCLES. Well, you have factors on both sides; you have the two forces contending. Certainly you have both inflationary factors and deflationary factors when the war ends. The deflationary factors will be surplus manpower with a heavy cancelation of war contracts and, with the demobilization, temporary excess manpower on the one hand which, in itself, is deflationary because it reduces the purchasing power, and with a surplus of war goods and particularly raw materials available on the markets and a great reduction of Government war expenditures. Those are deflationary.

On the other hand, your inflationary factors would be that at the time the war ends there will likely be the shortest possible inventories in the supply of consumer goods and the greatest demand. Those are inflationary factors prior to reconversion—that you will have the greatest purchasing power at that time in the hands of the public and you will have the shortest supply of civilian goods and you will have the greatest need. Now, there is a terrific inflationary force there that needs to be held in check. Until those idle men and factories can be reconverted and men get back into the production of civilian goods and services, they will be the factors that will create inflation unless prices are held down and unless rationing is continued long enough so that the supply will come somewhere near toward meeting the demand.

Miss SUMNER. Do you not think it rather a bankruptcy of planning when you have an inflationary bill like the Maury Maverick bill, the highway bill, and all those different bills voting billions to take care of unemployment and, at the same time you do not know whether you are going to have inflation or not, you are taking measures to control inflation?

Mr. ECCLES. The one thing you are going to have to do, you are going to have to provide employment. I think everything possible should be done with a view to providing that employment.

It is my judgment that most of that employment—in fact, you will have a pretty sure condition for employment as a result of private

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employment through the heavy backlog of demand for goods and services; that only the necessitous public expenditures should be made in the immediate post-war period, by city, county, State, and Federal Governments; that the longer programs should be reserved for a later period when it is seen that we have a deflationary condition developing. There is, of course, a certain amount of public works that must be done because of conditions of roads, highways, because of conditions of public buildings, both city and county and State and Federal. But your large projects, it seems to me, might well be deferred until we see the extent of the deflationary development.

Mr. SMITH. Mr. Eccles, you mentioned the need of deficit financing as a means of producing goods. You mean by that that we ought to repeat the experience of the thirties when we went into debt to create employment? Now did we produce those goods you referred to by deficit financing; would you repeat that experience?

Mr. ECCLES. Our national income went from something like forty to seventy billion dollars.

Mr. SMITH. I am not speaking about money for spending, but deficit financing to produce goods.

Mr. ECCLES. It takes purchasing power to purchase the increased production.

Mr. SMITH. That is not answering my question, Mr. Eccles. I want to know if those dollars actually produced; I do not mean what was given to people to go out and spend, but what did the dollars produce?

Mr. ECCLES. Well, you have the record here in Congress, a better record than I have, showing where the expenditures went. That matter was investigated time and time again and I know there must be records here showing just what each dollar was producing.

I cannot tell you just what every dollar of deficit financing produced, on public works, what W. P. A. was producing, but I know that in the period of 10 years there was $15,000,000,000 spent by the W. P. A. That is what happened, just in 10 years, $15,000,000,000 was spent by W. P. A.

Now, those $15,000,000,000 certainly gave a purchasing power to people that were certainly otherwise unemployed.

Mr. SMITH. The statement you make is——

Mr. ECCLES. Whether the 15 billion got 15 billion dollars worth of goods, public improvement, of course may be doubtful.

Mr. SMITH. I am talking about productive business.

Mr. ECCLES. That is right. But the war does not mean productive business, and yet we are spending $15,00,000,000 every two months and we don't seem to be particularly worried about the fact it is producing nothing, but when we talk about 15 billion being spent in 10 years to meet a situation, when we had no work for a good many people, to put men back to work——

Mr. SMITH (interposing). I am trying to find out what our experiment did. Did we succeed in doing anything of material or lasting benefit?

Mr. ECCLES. I think we succeeded, and if we had spent more money we would have succeeded more than we did. The trouble is that we spent two or three billion dollars a year in an effort to try to get 15,000,000 employed. That amount was just out of proportion to

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the effort. Our public effort was to try and furnish employment, and it was inadequate in relation to the problem that confronted us at the time, and yet I think we got amazing results when you consider the little amount that was spent over such a long period of time.

Mr. SMITH. Why was private industry hesitating, why did it not go ahead?

Mr. ECCLES. Because it did not have orders for goods. Consumption of things determines the investments in production.

Mr. SMITH. Do you not think the Government policy had something to do with it?

Mr. ECCLES. Oh, I think to the extent that the Government policy provided public works that helped out, but the Government policies were not adequate to make great enough purchasing power, and if it had been we would have had more business. For instance, just as quickly as we got into the war program and appropriated twenty to thirty billion dollars in the production of battleships, in the production of materials needed for the armed forces, we soon found ourselves with full employment, even though people are employed on things that are wasted.

Mr. SMITH. You do not call that prosperity, do you?

Mr. ECCLES. Well, you do not have unemployed people. The standard of living of possibly 50 percent of the people is higher under war conditions than it was under peace conditions.

Miss SUMNERS. But we are spending the future earnings in this generation that a lot of people in the future will have to pay for.

Mr. ECCLES. We need not. The future depends upon what is produced in the future and not on our money, and we know less about production in the future because we do not know what the people in the future will produce.

The CHAIRMAN. The House is in session and some members of the committee I am sure would like to be in attendance.

Mr. ECCLES. Mr. Chairman, I would like very much to get through today if I can. I will be unable to come back until next week, as I advised you at the beginning, unless you want me to come back this afternoon.

I have to attend the Open Market Committee meeting, which is fixed by statute, and also a conference of the Reserve bank presidents.

The CHAIRMAN. We will be glad to accommodate our time to yours.

Before you go: You believe the passage of this bill is absolutely essential if we continue the public debt transactions as presently operated in order to finance the war?

Mr. ECCLES. I think it is absolutely essential if the Federal Reserve System is not to sell a large quantity of Government bonds on balances. If the bill is not passed war financing in my opinion cannot succeed and we will have to sell a lot of bonds.

Mr. GAMBLE. Has a companion bill been reported in the Senate?

Mr. ECCLES. No. I went before the committee——

The CHAIRMAN. It had not been reported yesterday.

Can you come back the early part of next week, Mr. Eccles?

Mr. ECCLES. Yes; I can come back at any time that will suit the convenience of the committee.

The CHAIRMAN. We will let you know when we desire you to come.

(At 12:50 the committee adjourned to meet Thursday, March 1, 1945, 10:30 a. m.)

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REDUCTION IN RESERVE RATIO FOR FEDERAL RESERVE NOTES AND DEPOSITS

THURSDAY, MARCH 1, 1945

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Washington, D. C.

The Committee on Banking and Currency met, pursuant to notice, at 10:30 a. m., Hon. Brent Spence (chairman) presiding.

The CHAIRMAN. The committee will be in order. We will resume hearings on H. R. 2124.

We will hear from Mr. Burgess, who is president of the American Bankers Association. I believe he is vice chairman of the board of the National City Bank.

Mr. BURGESS. That is right.

The CHAIRMAN. I understand you have a prepared statement, Mr. Burgess.

Mr. BURGESS. That is correct, Mr. Chairman.

The CHAIRMAN. Do you want to read that without interruption?

Mr. BURGESS. I think perhaps that might be well.

The CHAIRMAN. Very well. The committee can interrogate you when you are finished.

STATEMENT OF W. RANDOLPH BURGESS, PRESIDENT OF THE AMERICAN BANKERS ASSOCIATION

Mr. BURGESS. I am directing my remarks, Mr. Chairman, to this bill, which will make permanent the right of the Federal Reserve banks to pledge Government securities back of their Federal Reserve notes, and which would also reduce the reserve percentages of the Reserve banks against their note and deposit liabilities from 40 and 35 percent, respectively, to 25 percent on each.

There are two reasons for the restraints on Federal Reserve action which are contained in the legislation you are discussing.

First, to place some limitations on the very great power which the Federal Reserve Act puts in the hands of a few people.

Second, to serve as red lights when a huge expansion or credit takes place, for such credit expansion is dangerous.

We are in the process of going through red lights. In addition to the bill before this committee a bill raising the debt limit is before Congress and that also means passing a red light. Inflation usually shows itself in rising interest rates, and we have suppressed, by Government control, not the inflationary forces themselves, but their danger signals.

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The danger signals are being passed but the inflation is going forward. The money held by the people, both in currency and bank deposists, is piling up in unprecedented amounts. We now have the same forces at work but in exaggerated degree that gave us the inflation of 1919 and 1920 and the crash of 1921. It took years for the farmer to recover from that boom and crash that carried wheat prices up to $3.50 and down to $1; that doubled the price of farm land and then dropped it back again.

The same forces later caused the real-estate and security inflation of 1927–29 and the later depression of the thirties. It took the war to pull business and labor out of that slump.

There are many signs that these inflationary forces are vigorously at work today. We see them in city and farm real estate and in all uncontrolled prices, in black markets, and lower quality of goods. The amount and quality of food, clothing, shelter, and service that the citizen can buy for his dollar is steadily declining.

We bankers are working with the Treasury in selling Government bonds to the people. We have put on a lot of pressure and incurred, I believe, a moral obligation to those people to keep their dollars sound. After World War I the prices of Liberty bonds dropped 15 percent, but their buying power in goods dropped more than that. Today the savings bond fortunately cannot drop in price, but its buying power can fall, and in fact is now falling.

This bill before the House removes certain automatic checks on credit expansion. To do so is a wartime necessity, but it means we must be increasingly alert. We ought to review where we stand on the inflation problem and take what steps we can to put the brakes in working order.

We, therefore, make the following definite suggestions:

1. That the bill be amended so that at the same time that the use of Government securities for Federal Reserve notes is made permanent, the 1933 emergency power to issue Federal Reserve bank notes and the power to issue greenbacks under the Thomas amendment of 1933 shall be repealed.

2. That the committee consider whether it may not be better at this time to lower reserve requirements to 30 rather than to 25 percent; 30 percent is likely to take care of the needs for many months, and if it then proves inadequate it will be because credit expansion has gone to a point where congressional review may be desirable.

3. That every proposal for Government post-war spending be scrutinized with great care. Government spending is the chief cause of inflation. We agree wholly with Chairman Eccles' statement that, "nothing would be more helpful to prevent inflation developing than to have a balanced budget shortly after the war." No campaign among the people and no price controls will be adequate to curb inflation unless the Government itself sets an example and puts its own house in order.

4. That the committee request the Federal Reserve Board to make a comprehensive report to Congress on the dangers of inflation and proposed methods for its avoidance.

That completes my statement, Mr. Chairman. I will be glad to answer any questions.

The CHAIRMAN. Mr. Burgess, you recognize, I think, the absolute necessity of legislation to carry out the general purposes of this bill?

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Mr. BURGESS. That is correct, sir. If I may summarize what this would do with respect to the bill, we would suggest that the bill be adopted just as it reads with respect to putting collateral back of Federal Reserve notes. There is no good reason, that I know, why that should not be made permanent now, instead of being renewed over 2-year periods.

We passed long ago the stage where you are anywhere near being able to cover the note issue with gold or eligible paper, and we are not likely to get back there for a good many years, so that it becomes a pretty mechanical problem and there is no point in bringing that before you from time to time.

The CHAIRMAN. Your only suggested change in the present law is that the reserve requirements be 30 instead of 25 percent, as I understand it.

Mr. BURGESS. We also would suggest that the power to issue Federal Reserve bank notes be repealed and the power to issue greenbacks under the Thomas amendment be repealed. I understand that Chairman Eccles is agreeable to those amendments. I have discussed that with him, and I think it was brought out here in the hearings on Tuesday.

Mr. BROWN. What is your reason for being against reducing the reserves 25 percent?

Mr. BURGESS. Mr. Brown, I would not want to be recorded as against it. We simply raise the question as to whether it is desirable to go all the way down to 25 percent, or whether going down to 30 percent might be adequate.

Mr. BROWN. I did not mean by my question to convey that impression. I just wanted to know the reason.

Mr. BURGESS. Yes; it is a question in the discretion of this committee. There is a certain amount of merit in having limitations for the Federal Reserve System, within which it operates, and if you have a credit expansion which is so great that it goes beyond those limits, then there is a good deal to be said for having them come to the Congress to explain why that credit expansion is necessary.

I think a 30-percent reserve would take care of anything that we can see ahead for some time. It would leave you something like $7,000,000,000 of excess reserves in the Federal Reserve System, that would take care of a very large credit expansion, so that it would take care of any foreseeable demands for perhaps a period of 2 years.

Mr. BROWN. You have given a good reason why it should not be permanent.

Mr. BURGESS. With respect to the reserve percentage?

Mr. BROWN. Yes.

Mr. BURGESS. No; I think the reserve percentage is a matter that could be made permanent. Of course, there are various ways that it would be dealt with less vigorously than this way.

One could suspend, for the period of the war, the present reserve requirements or drop that temporarily. My own belief, being with the Federal Reserve System for 18 years, and knowing those people pretty well, is that they will operate conscientiously and in the public interest. We should give them a very substantial amount of leeway. The only question in my mind, and in the minds of our group is, just how much leeway.

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I think there is merit in keeping the reserves as high as you can and still give them good leeway, because the reserve percentage has something to do with public confidence. People like gold behind their currency and they like just as much of it as the country can readily afford, so I am inclined to think that 30 percent would be adequate.

The CHAIRMAN. That is largely psychological, is it not?

Mr. BURGESS. I think it is. Mr. Chairman, I think economics is largely a question of psychology. That is one reason so many of our college professors go wrong; they do not understand psychology.

The CHAIRMAN. Do you think gold is absolutely essential to give validity and confidence? One hundred percent gold would be the logical thing, but 25 percent gold would not really be very much security, would it?

Mr. BURGESS. It would be less than 30.

The CHAIRMAN. I mean, for a long time we have gone on the theory that very little gold is sufficient to give security to the circulating notes of the Government.

Mr. BURGESS. Over a long period of years, gold has stood up pretty well and people have a confidence in it that they sometimes lack in governments. Governments come and go.

Mr. BUFFETT. Do you know of any case historically where there has been any satisfactory brake on political spending ever devised other than the gold standard?

Mr. BURGESS. I would certainly say that it is one of the best. I do not know of any better.

Mr. BUFFETT. There is this brake, certainly, the brake of regimentation as used in European countries, but other than that, I do not know. I wonder if you know of any.

Mr. KUNKEL. Mr. Burgess, when Mr. Eccles was in here, he gave us a reserve ratio, on December 31, 1944, of 49 percent and his projection showed that the reserve ratio would be 39.2 percent on December 31, 1945. Do you have any idea of how long it would take to cut down the reserve ratio, at once, on the 30 percent, and additionally, to where it was only 25 percent?

Mr. BURGESS. That would be guessing.

Mr. KUNKEL. I understand.

Mr. BURGESS. If it is now 49 and would be 39 by the end of the year, that gives us a general notion about the rate. Of course, as you go forward, it takes a bigger change. As you lower it, it takes a bigger change in notes and deposits to exhaust the ratio, but certainly 30 percent would last you to the end of 1946, even if the change were as fast as it is today and with a decreasing rate.

Mr. KUNKEL. It seems to be dropping at the rate of about 5 percent every 6 months, roughly.

Mr. BURGESS. Yes.

Mr. KUNKEL. If you lower the reserve percentage, then that rate does not go down quite so fast.

Mr. KILBURN. Mr. Burgess, what is the harm in bringing this up every year or two? You said to make it permanent.

Mr. BURGESS. You mean with respect to the notes, Mr. Kilburn? I do not know that it does any harm. Perhaps it is a formal matter. It seems to me that this is in the area where you know in advance

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of the request what you have to do. On the other hand, the reserve percentage is in a little different category. You have more room for judgment there.

Mr. KILBURN. Of course, if we lower it to thirty percent, and it follows the present trend, that would automatically bring it up, would it not?

Mr. BURGESS. That would bring it up automatically and I think there is merit in bringing it up for review before that red light is gone through again.

Mr. KILBURN. You just said in your statement, as I understood it, that it should not be made permanent.

Mr. BURGESS. No, I was dealing with the two different sections, Mr. Kilburn. I was dealing with the collateral for Federal Reserve notes, which I would make permanent because I do not think they are going to get out of that trap for a long time, but with respect to the reserve percentage, I think you could do that in two bits, to go to thirty, and that would probably take care of them through the end of the war. If it does not, it is probably a good idea to have the question reviewed.

Mr. SUNDSTROM. You said, in talking about the amendments that Mr. Eccles spoke of, that you felt he had no objections to it. Did you mean as to the other two amendments or the 30 percent, also?

Mr. BURGESS. No, I think he would prefer the 25 percent. I mean just the amendments with respect to currency.

Mr. SUNDSTROM. I know you have had 18 years with the Federal Reserve System. Do you think a 30 percent ratio would restrict them in any way, or interfere with their effectiveness?

Mr. BURGESS. No; I do not, Mr. Congressman, I think it would be adequate.

The CHAIRMAN. Mr. Burgess, in regard to making permanent the direct obligations of the Government as collateral for Federal Reserve notes, there would be very little chance of putting anything else behind them, is that not true? They do not now have any commercial papers?

Mr. BURGESS. Practically none, Mr. Chairman. They have two or three hundred millon dollars of discounts, but those in turn are secured by governments.

Mr. BROWN. When this war is over, they may have a lot more.

Mr. BURGESS. Let us hope they may. They might have more gold.

Mr. BROWN. That is the reason I say I doubt the advisability of making this permanent.

Mr. BURGESS. They may have more gold. I think the chances are very good for a gain of gold after the war.

Mr. THOM. May I ask a question?

The CHAIRMAN. Yes, Mr. Thom.

Mr. THOM. Mr. Burgess, the other day we saw a table indicating the reduction of Federal Reserve's account, putting them into seventeen or eighteen billion. That is rather an elementary question, but I would like to have you explain to us how that gold is going out of the Federal Reserve. I assume it is going out to foreign export. What are the mechanics by which it goes out?

Mr. BURGESS. May I first raise a question as to whether those figures are accurate, Mr. Thom?

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The present gold reserves of the System are, I think, about 20. But I think it has gone down about 3,000,000,000.

Mr. THOM. Just a moment; I had this projection.

Mr. BURGESS. Oh, that is the projection; yes.

Mr. THOM. It has gone from 28 to 18.2, in June 1945.

Mr. BURGESS. That is in his projection.

Mr. THOM. That would be next June, would it not?

Mr. BURGESS. Yes.

Mr. THOM. I see. December 31, 1944, is 18.7.

Mr. BURGESS. The process, Mr. Congressman, is that Brazil, let us say, is receiving dollars, because we are spending money in Brazil to build airports or to pay our troops there, and we buy Brazilian currency with dollars, which go to the bank of Brazil, acting for the Brazilian Government. They put the dollars on deposit with our Federal Reserve bank; when they accumulate a certain amount of dollars, they want to turn it into gold, so they go to the Federal Reserve bank and say, "We would like to buy $5,000,000 worth of gold and have it earmarked."

The Federal Reserve uses that deposit to buy the gold that they have in their vaults, and they earmark $5,000,000 in the vaults. That means they actually set aside that much gold.

Mr. THOM. Their purpose is to add to their own money reserves?

Mr. BURGESS. That is correct, yes. Also to add it in gold, so that they can show, in the statement of the Bank of Brazil, so much in gold, which indicates that people in different parts of the world still like gold.

The CHAIRMAN. Mr. Riley has a question, I believe.

Mr. RILEY. Mr. Burgess, when you lower the gold reserve, does that not have a tendency to create rapid expansion of credit, and then would that not go into inflation to a certain extent?

Mr. BURGESS. It would make possible the removal of one of the obstacles to an inflation of credit. But I think we can assume that the Federal Reserve banks will be operated in the public good, and that the amount of funds that they put to use will depend not on their capacity to expand, but on the public's need with respect to war financing. So, while it in a sense, as I say, goes through a red light, nevertheless, the action, itself, I do not think, is directly inflationary. The psychological effect is more important.

Mr. BROWN. Mr. Burgess, I want to congratulate you on having a short statement. Other witnesses have tried to cover too much territory, but you have boiled it down well, and I congratulate you on that.

Mr. BURGESS. Thank you, sir.

Mr. KUNKEL. Mr. Burgess, would it be about the end of 1946 when they reach the 30-percent ratio?

Mr. BURGESS. Or a little beyond that. All dependent, of course, on a lot of things we do not know about.

Mr. KUNKEL. Yesterday Mr. Eccles explained that it was a projection, but I mean that would be a fairly reasonable assumption?

Mr. BURGESS. I would think so; yes.

Miss SUMNER. I notice that you advocate repeal of the Thomas amendment, which you always have. Is it your idea that the Federal Reserve bank already has power to inflate the currency to such a degree that the Thomas amendment, in effect, is no longer necessary? Is that your attitude?

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Mr. Burgess. Yes; that they have plenty of power to issue currency to take care of any conceivable need, or any probable need, without having those emergency powers. The Thomas amendment was never used, in spite of the difficult times we have gone through. Those greenbacks were never issued. There was, from time to time, a threat of their issuance, which I think was a dangerous thing and disturbed confidence.

I remember very distinctly when the Federal Reserve bank note proposal was put into the Emergency Banking Act of 1933, it was put in while the banks were closed, with the thought that when the banks were opened, there might be an enormous demand for currency which could not be immediately met by Federal Reserve notes.

It did not turn out that way. There was no very exceptional need for currency. It began to come back, when confidence was restored, so the authority was hardly used at that time, and it has not been required since that time, although we have been through very unusual periods.

With this lowering of the reserve percentages, and with the authority to pledge Government securities back of the notes made permanent, I think there is no occasion for continuing these two inflationary powers. We do not need them.

Miss Sumner. In other words, because they are redundant?

Mr. Burgess. They are redundant, and also, I think this: We are in the unfortunate position of having to lower the reserve percentages. There is no way out of that. We are faced with it; it is a war need. The country is getting more and more concerned about inflation. If, at the same time, you vote to lower the reserve percentages, you take a step in the other direction, an anti-inflationary step, I think it would help public confidence in the situation. They say that at least the people on the Hill recognize the dangers, and when they take a step that dilutes the currency, at the same time, they are eliminating one of these things that is no good, one of these inflationary things.

Miss Sumner. Just one more question. Are you sure it would not have just exactly the opposite effect? A lot of people do not understand this position that we have with the Federal Reserve bank, that it can sell bonds and go on to create money and not understanding that, when they see a repeal of this Thomas amendment, when they are educated to believe it has a distinct power to flush currency out, are you sure it will not give them a false sense of security?

Mr. Burgess. That is a question of how the human mind works, which nobody is quite sure about. I would think it would work the way I have suggested, that is, the people who think about these money matters, and who write the news that other people read, would say, "Well, there is a sign of conservative action. They had to change the reserve percentages, but at least they did something to clean up some of the inflationary things in the set-up."

Miss Sumner. Do you think that the Thomas amendment is one on which there are fewer restrictions? I mean, to this extent, that the Federal Reserve bank is not going to flush out currency unless they are compelled to, whereas the other might go into action as a result of this pressure.

Mr. Burgess. When we created the Federal Reserve system, we set is outside of the political administration. We made it semi-inde-

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pendent, and we put the power of note issue in what President Wilson called a democracy of credit, with the Federal Reserve banks over the country.

The Thomas amendment comes along and puts the power to issue currency back into the political realm. It is not sound; it should not stay there.

Mr. SMITH. Mr. Burgess, I like the way you talk. I am wondering whether you have given any thought to the $2,000,000,000 stabilization fund as reserves; to add that gold to the present gold reserves. That might tide us over for 2 years without reducing the reserves 25 or 30 percent. I am just wondering, since it is proposed to take this $1,800,000,000 of stabilization fund and put it under foreign currencies to support their value, whether it would not be just a little bit better to take that and put it under our currencies to hold up their value.

Mr. BURGESS. Mr. Congressman, I had thought about that, since you raised the issue a couple of days ago, and of course, it is true that if that were put back of our currency, the need for lowering of reserve percentage would be reduced.

I think your time period, which you suggest, was perhaps a little optimistic.

Mr. SMITH. Pardon me; I did not figure it out absolutely.

Mr. BURGESS. Yes. I have not either. I think perhaps you are extending it a little longer than it would actually last. Two billion dollars is not a very large figure, and I think it would last perhaps 6 or 8 months, beyond what you have now, so that if you lowered the reserve percentages to 30 percent, you would be sure of going through 1946, let us say. If, instead, you took the action you suggest, it might just carry you into the middle of 1946.

Mr. SMITH. The question I am asking is whether it would not be a little more enlightened self-interest to put the $2,000,000,000 behind domestic instead of foreign currencies.

Mr. OUTLAND. Can you say that enlightened self-interest limits itself to the currency of your own nation?

Mr. BURGESS. No, I would agree with you, sir; that that is right. You are almost going to get me started on Bretton Woods, if you do not look out.

Mr. OUTLAND. You were already started by the previous question.

The CHAIRMAN. We are going to have a hearing on Bretton Woods next week, so I would suggest we do not attempt to enter into that subject now.

Mr. SMITH. Mr. Burgess, it is necessary, however, in setting up this program, to take those other factors into consideration?

Mr. BURGESS. That is true.

Mr. SMITH. We would assume a liability in the case of the bank to an amount that we cannot exactly determine at the present time, a part of which, or all of which might be a gold liability. No one can tell. The bank is not in operation. It involves the possibility of a large gold liability. It seems to me that all those factors should be taken into consideration.

Mr. BURGESS. I would certainly agree with that, sir, and I would agree with Mr. Outland that we have a very great responsibility in the world picture. The American Bankers Association is heartily in accord with there being an international organization. We have

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some suggestions to make in detail which we will cover when we appear before you.

Mr. SMITH. You are talking about the American Bankers Association?

Mr. BURGESS. Yes. But we are in agreement with the principle that there should be an international bank, and that bank must be supported with a certain amount of funds.

Mr. SMITH. But you are not talking about the international monetary fund now, you are talking about the bank.

Mr. BURGESS. I am talking about the broad principle, Mr. Congressman.

Mr. SMITH. I do not want to get into this other question, Mr. Chairman.

The CHAIRMAN. We will have plenty of that next week.

Mr. SMITH. It is a part of the picture and I do not see how we can avoid taking into consideration the projected liabilities that are involved in these proposals for an international bank and monetary fund. I noticed the other day that Mr. Eccles agreed that those factors were to be taken into consideration. Suppose this proposed reduction carries us over 2 or 3 years. If we do find we have assumed gold liabilities which will affect our gold reserves, we will again be called upon to consider this same question.

Mr. BURGESS. One could put that in another way, Mr. Congressman. If I were stating it, I would say this: The greatest contribution, without any exception, that the United States can make to world stability, and world trade, is to maintain the integrity of the American dollar.

Mr. SMITH. That is a fine statement, and that brings us back to exactly what I said. I do not see how we can escape the conclusion that it would be better for us to take this $2,000,000,000 and put it back of our own money than to put it back of foreign currencies.

The CHAIRMAN. Mr. Burgess, you do not think the integrity of the American dollar is endangered by the reduction proposed in the gold reserve, do you?

Mr. BURGESS. No, sir.

Mr. HULL. Mr. Burgess, how much further can we go before that happens?

Mr. BURGESS. Mr. Congressman, that is a question of human psychology. Inflation and deflation are not a mechanical problem. They are a question of how human beings react under given sets of circumstances. I think we have been very fortunate so far in the behavior of the people of this country. They have kept their heads, their savings have been huge, in spite of the tremendous flow of money into their hands. They have behaved extremely well.

When something would start that off, and change the stream of their psychology, no man can tell, and we must recognize that in this tremendous inflationary credit, there is a very grave danger. We must do everything we can to bolster that situation up and keep it sound. That would be my thought.

Mr. HULL. If conditions arise whereby you wanted to reduce this reserve from 25 to 15 percent and down to 5 percent, and then wipe it out entirely, are you not really starting on that kind of a merry-go-round right now?

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Mr. BURGESS. You are on that road, sir. The road that leads in that direction.

Mr. HULL. You refer here to the increase in farm real estate, increase in prices. Have you any figures that you could insert in the record showing where farm values have increased? For instance, we started with the foreclosure system a few years ago and wiped out a half million farmers, more or less, and land values went down, lots of them were sold for taxes. In what part of the country, today, can you get as much for the land and buildings as they actually cost and are actually worth?

In what part of the country do you have that inflation?

Mr. BURGESS. I would not be able to answer that, Mr. Congressman. The Department of Agriculture figures show that prices of farm real estate are up something like 40 percent compared with 1939. But I think we would all agree that the 1939 prices were still depressed prices; that the farmer never fully recovered from the deflations of 1921 and of 1932.

Mr. HULL. I come from a country in which we have a little farm land, and you can actually buy farms for less than you could today put buildings on it, with a farm thrown in.

Mr. BURGESS. Yes.

Mr. HULL. That is the condition right up through the Northwest, so I cannot find, from any inquiry I have made, where this inflation in farm values really has taken place.

Mr. BURGESS. We have some in New York State.

Mr. HULL. Possibly.

Mr. BURGESS. I myself do not feel that the inflation from land values has yet carried it beyond the dangerous point. I think we have been recovering lost ground. It is the direction of movement, rather than what has taken place, that I know the agricultural people are watching very closely.

Mr. BROWN. Is that not due partly to the fact that in crowded cities, a lot of people are moving out to farms?

Mr. BURGESS. There are lot of agriculturists as compared with farmers, yes, who think they get protection.

It is the inflation psychology working. People want protection somewhere, so they buy a farm.

Mr. BROWN. I do not fully agree with your written statement, to wit, "It took a war to pull business out of a slump, the slump of '27–'29."

Mr. BUFFETT. Mr. Chairman, we have a very good witness here. I would like to get a litle information. You speak of inflationary forces. Has there been any disastrous inflation in history that was not primarily due to governmental deficit spending? Is that not the cause of all this inflation?

Mr. BURGESS. Yes.

Mr. BUFFETT. In other words, when we talk about holding the line, on the part of prices, that is just incidental to holding the line on Government debt?

Mr. BURGESS. That is correct. The fundamental cause is debt spending.

Mr. OUTLAND. Mr. Chairman, following up that question a little bit, I am wondering if the implication back of it was that in the years following 1929, after the bank crash, there should have been abso-

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lutely no Government spending to try to keep millions of people from starving?

Mr. BUFFETT. I believe, just as President Roosevelt said in 1932, when campaigning, "If a family spends a little more than they take in for a few years, they can do that, but a continuation of that habit leads to the poorhouse" and I think that applies to the country. I think that the bankers will bear me out in that.

Mr. OUTLAND. The question I have asked has not been answered. That question was, Was the implication back of your statement that in the years immediately following the bank crash, there should have been no Government spending at all in the fields of social welfare and in the fields of public works, including the various other fields in which the Government attempted to combine, stimulating employment and actually helping people.

Mr. BUFFETT. I answered that when I quoted Mr. Roosevelt's 1932 statement. I agreed with that statement; I agree with it today.

Mr. WOLCOTT. Will you yield, Mr. Buffett?

Mr. BUFFETT. Yes.

Mr. WOLCOTT. You will recall in the fall of 1932, 3 years after the advent of the depression, Mr. Roosevelt advocated a reduction in Government spending.

Mr. KUNKEL. Mr. Burgess, as I understand it, Mr. Eccles definitely approves the repealing of the power of issuing the Federal Reserve bank notes. I quote from his testimony:

> Furthermore, the difference between Federal Reserve notes and Federal Reserve bank notes give rise to misunderstanding, and it would be simpler and less confusing to the public if Federal Reserve currency were all of one kind.

That is in his testimony, and then later on, he definitely says that he has no objection to the repeal of the Thomas amendment, or of the power to issue Federal Reserve bank notes. His position is practically the same, on those two suggestions, as yours, is it not?

Mr. BURGESS. That is correct.

Mr. WOLCOTT. Mr. Burgess, the President told us sometime ago that although he never expected to use title III of the Agriculture Investment Act, the so-called Thomas amendment, he more or less wanted it there as what we call a threat, to use if he had to use it at any time when the banks would not cooperate in taking Government issues.

I do not know whether the conditions in that respect have changed any more now than conditions were at that time, so I do not go along with the idea that the President wanted to have the Thomas amendment amended. He has changed his position completely to what it was before.

Mr. MONRONEY. Was that not in peacetime? Under war conditions it is a different situation.

Mr. WOLCOTT. He told us at that time very frankly that he hoped that we would not do anything with the Thomas amendment because he wanted to use that as a lever on the banks if they stopped buying bonds, to print the money with which to buy them themselves. The suggestion is that it is a rather typical type of shotgun proposition; that is the implication.

Mr. BURGESS. I think one might say that conditions have been changing in two particulars. The Banking Act, in 1935, which went into effect in 1936, gave the Federal Reserve Board larger powers

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with respect to the Federal Reserve banks. So that in the purchase of Government securities by the Federal Reserve banks, the Government agencies and the Board have a little more authority, also the gold reserves of the Reserve System have been built up so substantially that they have power to take care of a very considerable amount of buying of bonds.

Mr. WOLCOTT. As I understand it, your approval of this bill is predicated upon the fact that we repeal the Thomas amendment and the authority to issue Federal Reserve bank notes.

Mr. BURGESS. That is correct, sir.

Mr. OUTLAND. In case such amendments were not adopted, would you then disapprove of the legislation, Mr. Burgess?

Mr. BURGESS. No, sir. The legislation, in one form or another, is a "must." It has to be done in order to take care of the situation. We recommend that you do it that way.

Mr. BRUMBAUGH. To what extent do you think the black market is responsible for this increase in currency circulation?

Mr. BURGESS. That is very hard to answer, Mr. Brumbaugh, but it is certainly responsible to some extent, that and the dodging of income taxes. Of course, those are the transactions we do not see so much in the banks. But we do see a lot of thousand dollar bills, large denominations that are needed for illegitimate transactions. If one had to guess, I suppose he would sugggest that that amounted to two or three billion dollars, perhaps; that is a pure guess, though.

Mr. BRUMBAUGH. Do you think that will increase as wages go up and prices are supposed to be maintained at the present level? Do you not think it will force more into the black market?

Mr. BURGESS. And the war in Europe draws to a close, so that the atmosphere is less pervasive? Yes; I would think it would.

Mr. BRUMBAUGH. What do you think the solution to that would be?

Mr. BURGESS. Of course, money goes into hiding, and seeks black markets, and so on, with the more Government regimentation you have. The sooner we can withdraw the very high excessive taxes on business operations, and the regulations, and the sooner we can shuffle them off, the more you will have of a restoration of normalcy in monetary affairs.

Mr. KILBURN. I was interested in what you just said about the increase in currency being due to dodging income taxes. I think that is true, and I think it is true a great deal more than people realize. I do not know that this is germane to the bill, but is there any way that the banks can correct that?

Mr. BURGESS. I do not see that we have any way of getting at it, Mr. Kilburn.

Mr. SMITH. Mr. Burgess, you indicated that the gold, $2,000,000,000, might last about 6 months. I would like to get that correct.

Mr. BURGESS. I am afraid I am not in a position to do it.

Mr. SMITH. If we add $2,000,000,000 to the reserves, that would give us an additional reserve of $5,000,000,000 on the basis of 40 percent reserves, would it not?

Mr. BURGESS. That is correct.

Mr. SMITH. I think that amount would, after all, last a little bit longer than that. I have not figured it out accuractly.

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Mr. BURGESS. That may be. I would not attempt to say.

Mr. SMITH. There is a difference of $7,000,000,000 there between December 31, 1944, and December 31, 1945, so you would have $5,000,000,000 reserve to take up the $7,000,000,000. That would be a little more than possibly you had anticipated.

Mr. BURGESS. I think that may well be, Mr. Congressman.

The CHAIRMAN. Mr. Burgess, whether the authority to issue Federal Reserve Bank notes is repealed or whether the Thomas amendment is repealed or not, this legislation is absolutely essential if we are to continue to put gold behind our Federal Reserve bank notes, is it not?

Mr. BURGESS. Yes, sir; I think it is. I think there is a great advantage, however, in coupling it with the other action, in public psychology.

The CHAIRMAN. Support of Federal Reserve notes by direct obligations of the Government is absolutely essential under present conditions.

Mr. BURGESS. That power runs out June 30, and would have a very embarrasing effect if that were not carried forward.

The CHAIRMAN. It is about the only security we have for the present purpose at this time.

Mr. BURGESS. Yes; that is correct—that and gold.

The CHAIRMAN. So it is not a theory that confronts us, it is a condition that has to be met.

Mr. BURGESS. That is quite right, sir.

Mr. KUNKEL. In other words, necessity offers the Government another opportunity to pass a bad bill?

Miss SUMNER. What is the advantage of having Government securities as collateral? I mean, after all, you do not accept a borrower's note for another note as collateral. What, in your opinion, is the advantage of having it?

Mr. BURGESS. If you did not have it, these would simply be the obligations of the Federal Reserve banks. It is making assurance doubly sure. It is a good deal psychology. After all, the money of the country is what people rely on to do their daily business, and they like to feel that money is absolutely good. I think that it pays to have it bolstered in various ways.

It is an obligation of the Federal Reserve banks. It is secured partly by gold; it is secured partly by Government securities; it is also an obligation of the United States Government, and in that way we say the money of this country is doubly and triply secure. I believe that is sound policy.

Mr. BUFFETT. Regardless of how necessary this is, it is a step down the inflation road, is it not? Is it not a step toward managed currency?

Mr. BURGESS. That is correct, sir.

Mr. BROWN. As Mr. Wolcott said a while ago, there has been no issue on the Thomas amendment. I think the psychology might account for something. Just why do you want us to repeal that act?

Mr. BURGESS. For psychology, Mr. Brown.

Mr. BROWN. Psychology is worth a lot, is it not?

Mr. BURGESS. Yes; it is worth a great deal. I think, also, there is something in the point I mentioned a while ago, that the power

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to handle the money should be divorced a little bit from the political administration. That has been done in country after country through the central bank. England has its Bank of England that handles the note issue and so on. So that you bring to bear on the money problem, the minds of a group of people whose business that is, apart from the political administration. I think that is very important.

Mr. SMITH. Mr. Burgess, has the Bank of England done a pretty good job in holding down the note issues during this war?

Mr. BURGESS. I think they have done a very good job.

Mr. SMITH. Much better than we have?

Mr. BURGESS. I would not be sure of that. The increase in the note issue has been surprisingly similar in England and the United States.

They have a somewhat larger increase in prices.

Mr. THOM. The English Government has a parliamentary restriction on issuance of notes, is that correct?

Mr. BURGESS. They have lifted it pretty well for the war period.

Mr. THOM. They always have had a fixed amount above which application had to be made to Parliament?

Mr. BURGESS. That is correct, yes. Then they would make application, and they would be given rights. As I understand it, there is no limit on it at this moment.

Mr. THOM. I would like to have you discuss the proposed raise in the price of gold in order to accomplish the same purpose as this bill.

Mr. BURGESS. Yes, sir. That has been suggested, that an increase in the price of gold would increase the dollar amount of our reserves and do this job. I think that is a very undesirable procedure. In the first place, it is just fooling yourself. You are just cutting up your money a little finer and saying, "We have more of it."

In the second place, an increase in the price of gold is a highly inflationary procedure. It gives us that much more volume of money, not just here, but all over the world, because these foreign countries, that have money here, would benefit from it to a degree.

It would add fuel to the fires of inflation, and it would not be fair to the people to whom we have sold bonds, on the belief that they were buying a sound purchasing power, a sound money.

In the next place, the dollar, with the fixed gold price, is the anchor for the currencies of the world. It is more important for us to hold that anchor solid than any amount of monetary schemes you can get up. You have to have an anchor for world currency, something that you can count on, as a basis for any plan that you can think of for currency stabilization after the war. Without some measure of currency stabilization, trade is greatly hampered.

I would think that was a very undesirable procedure.

Mr. THOM. Would it increase the price of gold, tend to attract gold to this country, from the mines?

Mr. BURGESS. Mr. Congressman, we are getting just about all that there is, with the present price. I mean, in normal times we are. At the moment, the flow is impeded by the war, and shipping and the risk of shipping. But normally, we get a very large proportion of the world's gold. I think it would suck some gold out of the

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hordes in India, China, and out of the Central Bank reserves in other countries. They would send it to us quick before we changed our minds. We would be giving away our goods for the additional gold that we brought in. It might be a relief measure for the rest of the world, but rather an expensive one.

Mr. KUNKEL. Mr. Burgess, after the war, traffic will move in large quantities?

Mr. BURGESS. Yes.

Mr. GAMBLE. Mr. Burgess, what is your opinion on extending this pledge of Government securities for a definite date, rather than making it permanent in the law? Personally, I think it is a good thing to put a time limitation on a good many of these things, in these days.

Mr. BURGESS. With that latter general principle, Mr. Congressman, I would agree. I think that it is very important for these committees to review the monetary policy of the country from time to time.

On that particular point, it seems to me that it is becoming rather cut and dried. The system is so far away from being able to do without that bill that it is a question of "must" each time, without very much debate about it, so that it probably does not have the real effect of raising a real question.

The things you should discuss here are those where there is a real question, and it seems a pity to take your time on matters where there obviously can be no two opinions.

Mr. GAMBLE. Of course, the right of review at times is rather important.

Mr. BURGESS. Yes; I agree with you.

Mr. GAMBLE. Two or three years after the war, conditions may be entirely changed. I think it might be well to put on a time limitation.

Mr. BURGESS. I think you might be right as to changes in conditions.

I might call attention, Mr. Gamble, to the fourth suggestion we have made, that the committee should ask the Federal Reserve Board to make a comprehensive survey of the danger of inflation, and their suggestions for meeting it. While they might be willing to volunteer those suggestions, such a survey would require their covering an area broader than their own, and I think, therefore, they could only give you the survey that they are capable of making on request.

Miss SUMNER. I was going to ask you to comment on that and forgot. Was it your idea that that should be in the law, and did you want more than one survey?

For instance, conditions would change, I should say, at the end of 12 months. Would you think it would be a good idea to put in the law that they should bring in regular reports, at least once a year, for instance?

Mr. BURGESS. I do not know that I am enough of a parliamentarian to answer that, Miss Sumner. I would not think that it would be necessary in the law, but a formal request of the committee to the Board would be adequate.

Mr. WOLCOTT. You do think that perhaps in another year from now we had better take another look at this to determine whether it

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might not be advisable to require a certain percentage of commercial papers to put up?

Mr. BURGESS. I know what the answer would be when you took that look, Mr. Congressman, so I think it would be pretty formal.

Mr. WOLCOTT. In my own limited capacity, on this question, it seems to me that if you make permanent the authority to pledge Government obligations as securities for Federal Reserve notes, we are taking the attitude that there is, from now on, going to be little or no relationship between the needs of business and industry; in the money field, and that we tie our money permanently to our debt. A year from now we might want to place some further restrictions on the issuance of our currency, and go back as close as we can to the original purposes of the original act, having to do with a flexible currency, based upon the needs of industry.

I do not know whether we have a way of doing that. Perhaps it would require a percentage of the securities being in form of commercial paper.

Mr. BURGESS. That is exactly what the authors of the Federal Reserve Act had in mind. They thought of this currency as tied closely to the fluctuations in the requirements of business for credit. As a matter of practice, it has never worked out in that way.

The discounts flowing in and out of the Reserve bank have never been an index, really, of this business volume of the country, and there has never been enough of the so-called eligible paper in the Reserve System, except for very brief periods, to amount to anything as security for Federal Reserve notes. My own question is whether, at that particular point in the Reserve System, you have got a way of having a limitation that is really effective.

I am in complete sympathy with the suggestion that from time to time the Reserve System should come to you gentlemen with the request for a continuation of powers. I do wonder whether this is just the place to do it.

Mr. MONRONEY. I am afraid I agree with Mr. Wolcott, that we are going to get completely away from the commercial paper angle of the Federal Reserve banks. We got away from it long before the war.

Mr. BURGESS. Yes.

Mr. MONRONEY. Is that the fault of the act or a prejudice of local banks against putting up their paper for commercial paper deposit?

Mr. BURGESS. My own feeling, Mr. Congressman, is that it was a misconception in the original act, that they did not interpret the operations of the System as in fact they would take place. They placed too much importance on this flow of eligible paper, and so on.

Mr. WOLCOTT. Mr. Burgess, what control does Congress exercise over the amount of money, and in the quantitative theory, the more money we have, the less valuable it is.

Mr. BURGESS. The control of that, of course, is really in the amount of Government securities that the Reserve System purchases.

Mr. WOLCOTT. You are going to be called upon to purchase more of those from now on; is that no so?

Mr. BURGESS. That is right. The amount and the rate, the rate of discount, the interest rate, at which they are purchased.

Mr. MONRONEY. Should we have a period of several years of extremely high prosperity and rapid turn-over of business to where the

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public debt would decrease, and decline, which is just hypothetical, from three hundred billion down to a hundred billion, then you would shrink your monetary base, and unless you do something, as Mr. Wolcott, suggests, to replace that shrinkage of money, you would likely find business drying up.

Mr. BURGESS. You would shrink it by the Reserve System reducing its holdings in Government securities, which would reduce the amount of money outstanding in the market.

Mr. MONRONEY. What Mr. Wolcott is suggesting is that so many thousand bales of cotton or so many bushels of wheat inventory is a far better base for your currency than an excess amount of Government obligations.

Mr. BURGESS. Yes. You never get that flowing into the Reserve System under anything like the present circumstances, or anything conceivable.

One reason, of course, is that those of us who are bankers, when we are going to borrow from the Reserve System, would much rather roll up a bundle of Government bonds and throw it in than take a lot of business notes. Of course, the amount of commercial loans in the banks, right now, if you put them all in, is hardly adequate to secure these notes. But we do not want to borrow unless we can help it anyway. The money is put out usually by the Reserve System operating in the open market. That is the real window, and one point where you can exercise control is to watch this law which gives the Treasury the right to borrow directly from the Reserve bank. That should be repealed after the war.

Mr. BROWN. The use of wheat and cotton is another thing. What will the producers of those products put up with the local bank in order to get money?

Mr. BURGESS. They will put up their warehouse receipts, and so on. I think that would go forward just as usual.

Mr. BROWN. Then that could be used for the small local banks.

Mr. BURGESS. They do not want to do that if they can help it, of course.

Mr. BROWN. I am trying to hit the producers.

Mr. BURGESS. They get the money pretty well now, do they not, Mr. Brown.

Mr. BROWN. They do now, but I do not think they will later on.

Mr. WOLCOTT. Under this theory, if the local banks put up the security and then get the bonds, then they put up the bonds for the money.

Mr. BURGESS. The local bank has enough money of its own. It does not have to borrow it.

Mr. WOLCOTT. I mean in the ultimate transaction.

Mr. BURGESS. Yes. The thing that they did not visualize in the Federal Reserve Act was that the bank of issue is not something that is used for the great bulk of business transactions. The bank, of issue, the central bank, is used only in emergencies, and busy seasons. Just to take the top off, when the thing expands too much, and that means that the amount of paper that the central bank holds is very small ordinarily and in no relaion to the volume of currency in circulation.

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Mr. WOLCOTT. It always seemed to me that we could not have too much stability in the value of our currencies. It might be a fallacy; I do not know.

Mr. BURGESS. I think the problem there is to deal with the debt, if one can, Mr. Congressman.

Mr. WOLCOTT. We know we are not going to be able to do very much with a $300,000,000,000 debt. If we pay it off a billion dollars a year, and that is about the most we could do in the peak years of our prosperity, we can carry it, but it is going to be a drain upon our economy, because it is estimated that we have to take between 22 and 27 cents out of every earned dollar to carry this debt during the war.

Mr. BUFFETT. Mr. Burgess has there been any significant increase in the velocity of deposits in the last few months?

Mr. BURGESS. No, sir.

Mr. BUFFETT. How is that velocity in relation to a normal one of some years ago?

Mr. BURGESS. The velocity is still pretty low, because the volume has been increasing pretty much. The volume has been increasing as the bank holdings of Government securities have been increasing and so the volume has blotted out the activity.

Mrs. SUMNER. I notice you say in your statement that the amount of the debt at present worries you. It may be your opinion that it is not a debt to worry about, but if it is a debt that is a worrisome point, I wish you would say so, for this reason: When we are in the House, we have Members advocating more spending, and saying, "Well, you spent for this, therefore you can spend for this good project."

It would be very helpful to me, at least, if you, being an authoritative witness, and the debt does worry you, would say so at this point.

Mr. BURGESS. It does.

Mrs. SUMNER. Do you care to elaborate on that?

Mr. BURGESS. Yes; I do. I think the size of the debt, and its increase, is a very serious matter. It is a serious matter for two main reasons:

The first is, as the debt increases, it increases, for many years, the burden of taxes, and the burden of taxes is a weight on employment. It is exactly the opposite of full employment.

Taxes run up to four and a half billion dollars, which is not much compared to this war spending, but when you settle back to a normal period and add that to the other things you have to do, like keeping up national defense and taking care of the veterans, it is going to make a tremendous burden for business and individuals to carry right along, and that burden is going to be a handicap on enterprise, on the small businessman particularly, because he is the fellow who depends on using his earnings to build his business. A 40 percent tax, and now, in many cases, an excess-profits tax, because that hits the small fellow even harder than the large one, is a very serious handicap to the small man going into business or staying in business. From that point of view, the burden is very serious, and the other point is the inflationary effect.

This debt creates money; it creates bank deposits, and that is a terrific force toward inflation. We are headed for inflation just

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as sure as shooting, unless we do more about it than we have been doing.

Mr. OUTLAND. At that point, Mr. Burgess, will such large amounts of bank deposits and large amounts of currency continue to be an inflationary force when we are able to turn our productive systems to producing peacetime goods, rather than such a high amount of war material?

Mr. BURGESS. I am afraid it will.

Mr. OUTLAND. I mean, the point I was trying to lead up to was that if you can use those dollars to buy goods, rather than simply have to put them in the bank, or have to use them on the black market, rather than for productive enterprise, then it is definitely inflationary?

Mr. BURGESS. That is right.

Mr. OUTLAND. But when it creates more goods, which in turn can be bought, is it then?

Mr. BURGESS. Of course, your fundamental point is correct, that the prices are a result of a ratio between money and goods. You have more money than you have goods, so that it causes inflation. If you can create more goods, that helps. But old man psychology steps into the picture, and when you get very active business, and active manufacture of goods and so on, then this huge volume of money that you have starts rolling over faster, so it increases itself.

Mr. OUTLAND. But the inflationary danger now has been augmented, not only by the amount of money, but by the increasing shortage of goods, has it not?

Mr. BURGESS. Yes, sir.

The CHAIRMAN. I want to thank you, Mr. Burgess. We were glad to have your testimony on this subject.

We will now adjourn, with no definite time set for meeting.

(Whereupon, at 11:45 a. m., the committee adjourned.)

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REDUCTION IN RESERVE RATIO FOR FEDERAL RESERVE NOTES AND DEPOSITS

MONDAY, MARCH 5, 1945

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Washington, D. C.

The Committee on Banking and Currency met, pursuant to notice, at 10:30 a. m., Hon. Brent Spence (chairman), presiding.

Present: Representatives Brown, Patman, Monroney, Outland, Woodhouse, Wolcott, Crawford, Smith, Kunkel, Talle, Kilburn, Buffett, Hull, Riley, and Hoch.

The CHAIRMAN. We will be in order. We will continue the hearing and will resume hearing the testimony of Governor Eccles.

STATEMENT OF HON. MARRINER S. ECCLES, CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM—Resumed

The CHAIRMAN. The Governor has concluded his formal statement, I believe.

Mr. ECCLES. Yes.

Mr. PATMAN. I want to ask some questions, but I have not been here. I should think the members who have been here should discuss questions first. I did not want to just rush in when I have not been here.

Mr. BUFFETT. Mr. Eccles, under present conditions, we are operating domestically with what is apparently an irredeemable paper currency. Can you cite any instance in history where the use of the irredeemable paper currency has not resulted rather quickly in monetary chaos or slave economy?

Mr. ECCLES. I am not a historian on the subject. If what you say is true, every economy in the world will enter that unhappy state which you seem to think is due to a country that issues a currency that is not redeemable in gold, because there is no country today that is issuing currency that is redeemable in gold.

I think the fact that it is irredeemable or that the currency is not redeemable in gold, has no relationship to inflation.

Mr. BUFFETT. You think it has no relationship?

Mr. ECCLES. None whatever. Inflation comes from appropriations of congressional or legislative bodies in excess of their willingness to impose taxes to pay for the expenditure, and whether the money is created by the issuance of currency, or whether it is created by the sale of Government bonds to the banking system makes no difference. There is no more currency one way or the other. What I should

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say, is, it makes no difference in the amount of currency that is going to be in circulation.

Mr. BUFFETT. The gold standard in the past has operated pretty largely as a brake on that deficit spending. What brake that you know of has been devised as a successful substitute for that?

Mr. ECCLES. I do not think it acted as a brake at all. I think the minute it reached the situation where it was a brake in practically every country, they got rid of it. It did not act as a brake. The gold standard was maintained during a period when it was comparatively easy to maintain it, and when a period was reached where it could not be maintained, it was suspended.

The gold standard is pretty largely a sterling standard. It was managed by the British over a very long period of time; after the last war, when they ceased to be able to manage it, we ceased to have an international gold standard.

Mr. BUFFETT. Does it not sum up to this, then? So long as you have a balanced budget, you have a safe spending ratio, but whenever you depart from that you get on dangerous ground.

Mr. ECCLES. It depends on whether you have a lot of unemployment or not. If you have idle men and idle facilities, there is no danger of inflation.

Mr. BUFFETT. Did Germany not have a pretty serious regimented economy even though they had all their people at work?

Mr. ECCLES. They did not have them all at work. They had 6,000,000 unemployed.

Mr. BUFFETT. After Hitler was in power a year or two?

Mr. ECCLES. They had 6,000,000 unemployed about the time Hitler went into power. I do not know whether he got them to work that soon or not. One of the reasons that brought Hitler in was the terrific economic depression and unemployment that Germany had.

Mr. BUFFETT. That is correct. I want to ask you this question now. Is the Federal Reserve taking any specific, constructive, and corrective measures concurrently, to this gold ratio reduction, to assist Congress in its efforts to prevent disastrous inflation?

Mr. ECCLES. I know of no way that we could be of any assistance to Congress, unless Congress sought our advice and unless our advice was possibly accepted.

Mr. BUFFETT. Certainly; the Federal Reserve Board is considered by the American people as a great nonpartisan authority on finance; is that correct?

Mr. ECCLES. I would not say so.

Mr. BUFFETT. In any event, it is the top financial authority in this country, and Congress should have the benefit of its recommendations at all times.

Mr. ECCLES. It is an agent of the Congress, and it reports to the Congress. There is no question about that. However, its powers and its authority are extremely limited insofar as dealing with the effects of either inflation or deflation. It is greatly overrated insofar as having any authority to deal with the subject is concerned.

Mr. BUFFETT. In the adoption of this legislation, we are going through what Mr. Burgess called the red light. Do you not think it would be appropriate for the Federal Reserve Board, in connection with that, to present any and all recommendations it has to Congress to help preserve the stability of our monetary system?

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Mr. ECCLES. It would be presumptuous for the Federal Reserve System, unless it was specifically requested by the Congress, to undertake to propose the ways and means by which the economy may be operated so as to prevent inflationary development.

Mr. BUFFETT. It does not seem practical that the Congress would ask what they should do. You come to us with a proposal to reduce the gold content. Corollary to that certainly are all these other problems.

Mr. ECCLES. Of course, I do not agree that they are corollary, at all, to the reduction of the gold that may be back of the currency.

Mr. BUFFETT. It seems to me that is all part of the problem dealing with the stability of our monetary system.

Mr. ECCLES. As I say, that is basically the question of the budgetary deficit, nothing else. So long as you are in a war, you are unwilling to impose taxes to balance the Budget, and you are going to expand purchasing power. As you expand purchasing power when your manpower and your productive facilities are fully utilized, you cannot supply the goods to meet the increased purchasing power and you have pressures. You can deal with them only by direct means, not through monetary action. The way you must deal with them is through your price control, your rationing, your allocation, your export licenses, your wage controls, your taxation. That is the only way you can deal with the pressures; and there is nothing you can do in a monetary way.

You certainly cannot adopt a restricted monetary policy at a time when the Government is placing fifty to sixty billion dollars of securities, at a time when the public owns $250,000,000,000 of securities, you cannot undertake to say that we are going to make credit difficult to get.

Mr. BUFFETT. No; but on the other hand, you can say to Congress, at a time like that, that the Federal Reserve System figures that there should be enacted new taxes and make that recommendation regularly and energetically. I know you have done some of that.

Mr. ECCLES. Of course, that has been done by the administration through the President's message. He proposed ten or fifteen billion dollars of additional taxes 2 years ago. The Treasury has proposed additional taxes; for the Federal Reserve to come into the field and undertake to provide a leadership in that, would seem to me rather presumptuous.

I, personally, have made statements before the Ways and Means Committee on this question of taxation. I have filed a statement with them 2 years ago, in which I called for substantially more taxes than were being proposed, and I presented the arguments why additional taxes were necessary; either that or a reduced expenditure.

Mr. BUFFETT. You believed that then, and you believe it today, of course?

Mr. ECCLES. It certainly has been true for several years. It has been true for 3 years. We have been running an annual deficit here of better than fifty or around fifty billion dollars, I would say, for 3 years, of which over $20,000,000,000 has been financed by bank credit, by the creation of new money.

That has been going on continuously for 3 years and right in the face of that people generally are talking about less taxes, instead of more taxes.

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Mr. OUTLAND. Will the gentleman yield?

Mr. BUFFETT. Yes, sir.

Mr. OUTLAND. It seems to me that the witness is bringing out an excellent point; namely, if we are going to prevent inflation, that one of the key things is to pay a larger proportion of our war debt, especially as we go along. I can cite two instances, however, of where that has been recommended and the Congress of the United States has turned it down.

One, in the so-called Ruml plan, or modified Ruml plan, which cost the Nation a great many billion dollars in extra currency, and the other in the overriding of the President's veto.

Mr. BUFFETT. I would not debate the first one or the second, because that is not in connection with this. But certainly in the overriding of the veto, we did not take away anything. We may have foreclosed the possibility of raising more than the 2 billion in taxes, but we did not take anything away. I believe that the Congress should be enacting more taxes. I said so since I first came down here. But unless an authority, like yourself, keeps that message pretty regularly before Congress, Congress is going to do as Congresses have always done, treat that as an unpleasant subject.

Mr. ECCLES. I issued a statement on Saturday morning to the press with reference to the capital-gains tax. When I was before the Senate committee 2 weeks ago, this very question that you are discussing was raised by Senator Taft, and he made the point that we had direct controls, dealing with prices, wages, through allocations and rationing, but he said they do not apply to capital assets, such as stocks, real estate, farms, homes, and other properties which are rising rather rapidly in value, and where a lot of money is going.

He said, "How would you stop inflation in that direction?" Not knowing that he was going to ask the question, I made the best answer I could, extemporaneously, and there was considerable misunderstanding of what had been said. I got a lot of correspondence on it, and in order to have something to answer the correspondence, and to clarify it, I prepared a statement. I do not intend to read this statement, because it is rather long, but it covers that aspect of the inflation problem.

I do want to read one paragraph, because it bears on this very question which you have raised regarding capital-gains tax, as a war measure.

> The proposed tax is a wartime expedient, such as price, wage, and other direct measures of control that deal with the effects and not the causes of inflationary forces resulting from huge deficit financing of the war.

You are dealing with the effects and not the causes, and this proposal was merely another proposal to deal with the effects.

> Had the public, and hence Congress, been willing to deal with inflationary causes, rather than effects, deficit financing would have been held to a minimum by far higher taxes, and by far greater economy and efficiency in war expenditures. Some of us urged that course from the outset, but since it has not been followed, the only alternative is to deal with inflationary effects by such expedients as are necessary to hold the line, so long as inflationary dangers exist.
>
> After reconversion, demand, which has so vastly exceeded supply in wartime, should be met by fully employing our manpower and material resources in peacetime production, and creation of further inflationary forces should be ended by greatly reducing public expenditures, and by maintaining such taxes as are necessary to bring about a balanced budget.

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Mr. BUFFETT. I would like to ask you, in that connection, do you not think that there is large measure in this country of self-deception, that we think that by holding the line on prices, we are preventing inflation where we should be really holding the line with more effective measures on deficit spending?

Mr. ECCLES. That is exactly what is said here.

Mr. BUFFETT. Yes.

Mr. ECCLES. That is, that you were dealing with effects through these direct measures rather than dealing with causes. I think no country, except Russia, has been able to deal with the causes. All other countries have done just as we have. They have dealt with the effects, because in a democracy, the people are unwilling to have imposed upon them the conditions that would be necessary to deal with the causes.

In Russia, they have just proceeded to deal with them, and so, as a result, the people of Russia get little, if any, more money than there are goods available for them. Therefore they do not have this same danger of post-war inflation, or the same danger of inflation during the war period that calls for these numerous direct controls which become increasingly difficult to administer as the purchasing power of the public in general expands, and as the supply of goods available to purchase diminishes.

Mr. BUFFET. Is it not true that the longer the inflation proceeds, the more danger there is that eventually we will wind up with a total regimentation such as Russia has?

Mr. ECCLES. There is no question that the longer the war continues, the greater will be the inflationary pressures, because we will continue to finance the war through deficits, and we will continue to increase the purchasing power of the public, add to their cash holdings and Government bond holdings, and we will continue to diminish the things they can buy.

How long we can hold the line through direct means is anyone's guess; unless there is a will on the part of the American public and the Congress to deal with this rigidly until such time after the war as we get the supply somewhere in balance with the demand, we are confronted with an imminent danger.

Mr. KILBURN. I wonder what you thought of putting on amendent in this bill to repeal the 1935 emergency power to issue Federal Reserve bank notes, and the power to issue greenbacks under the Thomas amendment of 1935.

Mr. ECCLES. That was a proposal that Senator Taft made in the Senate, and Mr. Burgess, the president of the American Bankers Association, said that proposal comes from the American Bankers Association.

Mr. KILBURN. That was in Mr. Burgess' testimony?

Mr. ECCLES. Yes; they communicated with me, and I told them that it seemed to me that these were powers that had not been used; they had been put in in a period of depression. They had never been used even during the depression period. There was certainly no likelihood that they would be used, and I would like to see the bill passed by both the House and Senate without amendment, to get it through as quickly as possible. I also told them that if amend-

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ments were offered, there was no telling the extent to which other amendments might be offered.

I see no objection to the amendments that were proposed, but I told them that I was sure there would be no danger whatever that the power or authority would be used because there was no need to use it.

Mr. KILBURN. You have no objection to such an amendment except that you think it might hold up the bill; is that right?

Mr. ECCLES. That is right. I had no objection to such amendments if there were no other amendments made in the bill.

The A. B. A. proposed another amendment. They proposed the amendment that the gold reserve requirement, instead of being reduced to 25 percent, be held to 30 percent. I said that I certainly would not favor that amendment. I felt that if the two amendments, repealing the Thomas currency, and the Federal Reserve bank notes power, were passed, that the only currency that would be available to be issued would be Federal Reserve notes, and that there should not be the gold limitation to a 30-percent reserve requirement; that it should be not more than 25; and I still feel that way.

Mr. KILBURN. I do not think we should proceed on the theory that we should not put in amendments, because it might hold up the bill.

Mr. ECCLES. I do not think the amendments are important. I think they are purely academic. If they were important, that would be true, but I think these amendments are purely academic.

Mr. KILBURN. You have no objection to them?

Mr. ECCLES. I have no objection to them.

Mr. PATMAN. Mr. Chairman, may I ask the witness a question or two?

The CHAIRMAN. Are you through, Mr. Kilburn?

Mr. KILBURN. Yes.

Mr. WOLCOTT. I would like to know along that line whether you would like to revise your remarks. I gathered from what you told Mr. Kilburn that the reduction from 40 to 25 is predicated upon the necessity for leaving the Thomas amendment, and the other amendment as it is.

Mr. ECCLES. No.

Mr. WOLCOTT. On the strength of the fact that otherwise, if we reduce it to only 30 percent, you might have to use the Thomas amendment and might have to issue Federal Reserve bank notes.

Mr. ECCLES. I did not mean to give that impression. It seems to me that if you are going to eliminate the power to issue the $3,000,000,000 of Thomas amendment currency, and if you are also going to take away the power, which was unlimited, to issue Federal Reserve bank notes, then there certainly would be little reason for reducing the amount by which you will lower the minimum reserve ratio.

That seemed to me to be a restriction that was unnecessary. I do not know that we would go to 30 percent. If we should get to 30 percent and there was then a hesitation to go to 25 percent, and the Thomas amendment were out, and the Federal Reserve bank notes were out, it would seem to me that it is a move in a restrictive direction. I do not have any idea that the gold reserve requirement will go below 30 percent, and yet, with the loss of gold that has been going on here for the past 2 years, when we have been losing about a billion dollars a year, we could lose more, because foreign countries have large cash

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balances here. They could draw those balances out and put them in earmarked gold. I think those balances in this country are over $5,000,000,000.

Just assume that they had an idea that we were going to change this price of gold, such as has been proposed here in the last week or two. I think the bill was recently introduced where we would increase the price of gold to $56 an ounce. If these countries had an idea that there was any possible chance of that, they would not want to be caught with dollars; they would want that whole 5 billions or 5½ billion dollars in the form of gold, so that if the price of gold were changed from $35 to $56, they could then sell the gold back to us at a profit.

As long as we are talking about bills that are being introduced and debating the possibility of increasing the price of gold, which of course I think is terribly remote, there would be the possibility of, as I say, drawing out these dollar balances, which are already in cash. Besides that, there are billions of dollars of short-term securities which could also be sold, and the dollars transferred into gold, so that possibly half of our gold supply could be drawn out and requests made that it be earmarked. Instead of having $17,000,000,000 of gold as proposed here, we may have 8 or 9 billion dollars of gold. That is a possibility.

In that case, the present gold coverage could not be met and you would want to issue Federal Reserve bank notes. You would want to reduce the gold requirement further.

Mr. Patman. Mr. Eccles, I have a question I want to ask you. What about this proposal to limit taxes, in the Federal Constitution, to 25 percent? The proposal commenced about 1939. I never heard of it until less than a year ago, and then 17 State legislatures had already petitioned Congress to call a constitutional convention to repeal the amendment XVI, the taxing amendment, and to substitute therefor a provision that would limit all estate, inheritance, and income taxes to not exceeding 25 percent, and I got to investigating the situation. These legislatures were very quietly approached and, in a number of cases, even in the last day of the legislative session, got it through both houses. They worked very quietly, but effectively.

They are renewing their efforts in all of these State legislatures now. Most of them are in session at this time, in most of the States. What, to your mind, would be the effect of that amendment if it were adopted today?

Mr. Eccles. I cannot imagine any piece of legislation that would be more inflationary than to adopt any such restriction on taxes. If anyone were going to consider seriously a restriction on taxes, they should also, at the same time, provide as a corollary to such a proposal, that appropriations be restricted in line with the taxes that we were able to collect on that basis; you certainly could not restrict taxes and then leave the appropriation doors wide open.

Mr. Patman. Or the power to print money, either.

Mr. Eccles. Of course, the power to print money would not make any difference, because if Congress runs a deficit the inflationary danger is there so long as you have a shortage of manpower and productive resources to meet the demand. Whether you eliminate the power to issue currency or not, does not eliminate the inflationary danger at all. The tax proposal—the limitation-of-tax proposal—

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would be as thoroughly unsound as any proposal I could imagine being passed.

Mr. WOLCOTT. Will you yield, Mr. Patman?

Mr. PATMAN. Yes.

Mr. WOLCOTT. I wonder if the State legislatures have submitted a petition for that particular amendment.

Mr. PATMAN. Yes; it is pretty well organized and coordinated.

Mr. WOLCOTT. It is not in the memorials of Congress.

Mr. PATMAN. No; they are operating under article V of the Constitution, which, it is contended by many good lawyers, in the event 32 States petition Congress to do a certain thing that Congress is required to do it.

In other words, it is compulsory.

Mr. WOLCOTT. I think that is right, if they ask Congress to do a particular thing.

Mr. PATMAN. They are asking for a particular thing. They are using the same language.

Mr. WOLCOTT. Do they set forth the language of the amendment?

Mr. PATMAN. Yes; they do.

Mr. SMITH. Mr. Patman, that constitutional convention, or whatever you might want to call it, would be permitted to make recommendations to Congress or to amend the Constitution only in respect to the one thing; is that the idea?

Mr. PATMAN. Of course that is my idea. But their idea is that once they have a constitutional convention, they are not restricted to that; that they can include anything else.

Mr. SMITH. Does the Constitution not so instruct them specifically?

Mr. PATMAN. I do not think Congress has the power to do that.

Mr. SMITH. The legislatures, I mean.

Mr. PATMAN. The legislatures are specific in what they want, and if they get 32 of them to pass a resolution, it is claimed that Congress will be compelled to act. The Senate committee agreed, when this war commenced, that they would not have any constitutional amendments submitted during this war for reasons that all of us know.

This even gets around that. You see, this is the States petitioning Congress in order to compel Congress to do it, and I believe that the Senate committee would tell you that they would be bound, if this proposal were adopted by 32 States, to go ahead, notwithstanding the fact that the war is on, and submit it to a constitutional convention.

Mr. SMITH. It is your opinion that once they get together they could pass on anything?

Mr. PATMAN. Sure.

Mr. WOLCOTT. I do not think so. I do not think the Constitution provides that method of holding constitutional conventions. It said that the Constitution may be amended in these two ways, but I do not think there is any obligation, as I recall the Constitution, for Congress to call a constitutional convention.

Mr. PATMAN. It seems that lawyers always differ; half of them are always wrong in a case, and there is a difference of opinion in this. Some lawyers say they can and some say they cannot. But I am convinced that they would not be restricted.

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Mr. WOLCOTT. What would happen if the Congress just tabled the matter and did not do anything with it? You cannot mandamus the Congress.

Mr. PATMAN. No, you cannot compel them, but at the same time that obligation is there, and of course the theory is that these State legislatures, if you restrict the taxes that they can levy and collect, then the States can levy and collect more taxes. But, in effect, it would not be done, because some States would advertise, "Come to Texas," or "Come to Florida," and other States, "We will not have any income tax." Or "We will not have any estate tax." The States would be in competition with each other.

The CHAIRMAN. What States have taken that action?

Mr. PATMAN. Seventeen States.

Mr. OUTLAND. Will the gentleman yield to an observation there?

Mr. PATMAN. Yes.

Mr. OUTLAND. The essential point of the matter you raised is not, if such a constitutional convention were called, could it take up other matters or not. The question is whether this particular proposal is inflationary and discriminatory and has certain unfortunate political ramifications.

Mr. PATMAN. Certainly, and if it were to pass, we would have an awful hard time raising enough money to pay the carrying charges on the national debt, providing the national debt is as high as $300,000,000,000 or substantially that amount. Then there would be no money left for veterans of this war who are injured, and for the dependents of those who are killed, or for any other purposes.

It would just ruin the taxing power of the Federal Government, and, of course, jeopardize the safety and security of the Government bonds.

Mr. SMITH. Mr. Patman, I think the Times-Herald took that position that once they got together they could do anything.

Mr. PATMAN. A number of publications have. But I have looked into it, and I am personally convinced that they cannot. As Mr. Outland points out, that is not the important thing in this. They certainly can consider this particular proposal and that is the one that I personally am concerned about.

Mr. ECCLES. I cannot believe that the American public seriously would support any such proposal, because such a limitation on income taxes would mean an imposition of very high excise taxes, or sales taxes, which, of course, would be regressive. Although such taxes may be all right in time of war, and all right as anti-inflationary measures, in time of peace, at a later date, the employment problem may become a serious one, and at such a time, a sales tax would be the very kind of tax that you do not want because it would reduce consumer demand and purchasing power. An additional tax limitation such as is proposed on incomes, of course, would force a very heavy general sales tax.

Mr. KILBURN. One more question, Mr. Chairman, if I may.

The CHAIRMAN. Mr. Kilburn.

Mr. KILBURN. I just wondered, Mr. Eccles, if you thought that the administration were opposed to the amendment of this bill repealing the bank notes provision and the Thomas amendment.

Mr. ECCLES. I would not be opposed to it, if there are going to be any amendments offered. As I said before, I preferred that there be no amendments, and that the bill get through as it is.

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Mr. KILBURN. You do not know the administration's stand?

Mr. ECCLES. The administration have not been interested in this bill except the Treasury. The Treasury, of course, was favorable to it, recognizing the need of it. The President mentioned it in his Budget message. I do not know of any other Government department that has paid any attention to it or really understands it. It is really the responsibility of the Federal Reserve Board to make the proposal, and we have made the proposal without consulting anybody except the Treasury. It is a technical matter and nobody else would be familiar with it or would be interested in it.

Mr. HULL. Mr. Eccles, could you put in your statement, in the record, the complete account of the withdrawal of gold, cash balances entries, and all other information regarding the depletion of our gold supply in our country, and to such extent as we can find out what countries are shipping gold?

Mr. ECCLES. That is not available. I do not think the Treasury would make that available.

Mr. HULL. Is it possible to get the information by way of illustration, as to how much gold has been shipped to France or Argentina, or any other country?

Mr. ECCLES. I do not think it is. We do not have that information.

Mr. HULL. How can we act on this bill without knowing what has become of the gold reserve?

Mr. ECCLES. You can find out what the total is. The Treasury have not made available the detail of the gold receipts or the gold withdrawals since the war.

Mr. HULL. France now wants 2½ billion dollars, a lend-lease loan, I presume. Is there any way of finding out how much gold France has available in this country?

Mr. ECCLES. As a war measure, the Treasury has not made available the source of the receipt of any gold, as I understand it, or the country that has withdrawn gold. You would have to take that matter up with the Treasury. We do not have the information. We only have total figures. We know the total assets of gold and the total withdrawals, but where it comes from and who gets it, we do not know.

Mr. HULL. Has anybody any right to know—when this question comes up as to how much gold they are drawing out of the Treasury, and for what purposes, that is?

Mr. ECCLES. I am not an authority as to what the rights may be, at all. I could not say whether the Congress has that right or not. I suppose it has the right to request it. Whether the Treasury would be required to give it or not, I do not know.

Mr. HULL. You have no right to demand it for the Federal Reserve?

Mr. ECCLES. We have no rights whatever in that regard.

Mr. HULL. In other words, this is a blind man's buff game. You do not know who is getting the gold or anything.

Mr. ECCLES. It makes no difference at all to us in our monetary operation, which is purely domestic. We have nothing to do with the international monetary operation.

Mr. HULL. If one country is getting practically all of this gold, that would have some significance, would it not?

Mr. ECCLES. It would make no difference so far as the reserves are concerned, whether it was widely distributed or whether one coun-

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try got it all. So far as the reserves were concerned, the effect would be exactly the same.

Mr. OUTLAND. Mr. Eccles, this question is perhaps more hypothetical, but there are some practical ramifications to it. I wish you would comment upon it. Rumors have been stated from time to time that there have been tremendous deposits of gold discovered in Siberia, fantastic amounts of it. Suppose that that rumor were true. It would be perfectly possible then, would it not, in the post-war period, for that gold to be sent into this country for our automobiles, our refrigerators, all the other goods that we produce here? We would have a so-called favorable balance of trade; we would have a sound currency, but we would be in an awful position economically.

Mr. ECCLES. If it is as fantastic an amount as you propose, of course, that would be true, if we permitted a free exportation of our goods. If we kept it on the present controls, it would not be true, because today what is exported is done on the basis of export licenses.

Mr. OUTLAND. I was thinking in terms of a post-war period, when probably many of those controls will be removed.

Mr. ECCLES. If the Congress repealed the power to license exports, then that would be true. So long as we stood ready to purchase all of the gold in the world at $35 an ounce, or at whatever figure it is that would provide dollars, then anyone owning the dollars could buy what they wanted with the dollars and ship the goods where they wanted to ship them.

Mr. MONRONEY. If such case would occur, would it not automatically lower the world price of gold?

Mr. ECCLES. It would not automatically do it.

Mr. MONRONEY. It would eventually do it.

Mr. ECCLES. I do not know whether it would or not. We would certainly have to change our present policy of buying gold at $35 an ounce, and at any time that we changed that price downward, Congress would have to appropriate enough money to take care of the loss on the gold which we held.

In other words, if we had $20,000,000,000 worth of gold, and the price was reduced by one-fourth, there would be a $5,000,000,000 adjustment that would have to be made, and Congress would have to appropriate $5,000,000,000 to take care of the loss on the gold by devaluing downward. That seems to me a very good reason why we certainly should not increase the price of gold above $35, because the higher the price the more gold we are likely to get, and we have no use for the gold.

Mr. OUTLAND. I wanted to ask one question growing out of that possible situation, which is, in your judgment, Mr. Eccles, is it a more sound procedure to tie in the issuance of currency or to tie in our entire monetary values, to the amount of gold available, or to the productive capacity and record of the Nation?

Mr. ECCLES. We will adjust the gold situation to meet that later. We will not let the gold, in the future, be a deterrent to the employment of people in the production of goods.

Mr. OUTLAND. Thank you.

Mr. WOLCOTT. Mr. Eccles, have you the Treasury's daily balance sheet before you?

Mr. ECCLES. No; I have not.

Mr. WOLCOTT. Do you know what the approximate amount of gold is that we have at the present time?

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Mr. ECCLES. I put it in that statement to the committee. At the end of the year we had $18,700,000,000 worth of gold.

Mr. SMITH. Does that include the stabilization fund?

Mr. ECCLES. That does not include the stabilization fund. You would have to add $1,800,000,000 to that in order to get the amount of gold which was available at that date in this country.

Mr. WOLCOTT. That would be approximately——

Mr. ECCLES. That would be twenty and a half billion dollars.

Mr. WOLCOTT. Twenty billion dollars, approximately?

Mr. ECCLES. Yes, sir.

Mr. WOLCOTT. How much of that is available as a reserve?

Mr. ECCLES. The $18,700,000,000.

Mr. WOLCOTT. I see. $18,700,000,000?

Mr. ECCLES. Yes.

Mr. WOLCOTT. Is that all represented in your gold notes?

Mr. ECCLES. That is all represented in gold receipts, that is right.

Mr. WOLCOTT. Gold receipts?

Mr. ECCLES. Yes, sir.

Mr. WOLCOTT. The Federal Reserve have $18,700,000,000?

Mr. ECCLES. As of December 31, in gold receipts, and that gave us a ratio of approximately 49 percent for the System as a whole.

Mr. SMITH. This credit which is being considered to be extended to France, could she use that credit to buy our gold and actually transport it to her country?

Mr. ECCLES. I know nothing about any credit to the French. All I know is what I have seen in the paper, and what I have seen have been mostly rumors. I really do not know what credit has been extended to France, if any.

Mr. MONRONEY. Is that under lease-lend, Doctor?

Mr. SMITH. Yes.

Mr. MONRONEY. That has to be a defense article.

Mr. WOLCOTT. Wait a minute. That is a very serious question. Long term loans on lend-lease; we are going to have to give consideration to it during the next 2 or 3 weeks, since there is proposed two or three billion to France, six billion to Russia, and six billion to China. I do not think the Congress has attempted to make a long-term loan on lend-lease. We should take some action on that immediately.

Mr. MONRONEY. Is it loans or goods?

Mr. WOLCOTT. What are you going to take in in goods? What can this country allow them to take out in goods? Surely we are not going to take $6,000,000,000 of caviar from Russia.

Mr. MONRONEY. We could use the wood pulp.

Mr. SMITH. The reason I asked that question is, we have given credits to certain nations who can use those credits to buy gold and actually transport it to their countries.

Mr. MONRONEY. That was not under lease-lend. That was under commerce, was it not?

Mr. SMITH. I suppose so.

Mr. MONRONEY. That is on maintaining the trade balance?

Mr. WOLCOTT. You cannot have your cake and eat it, too. The reason we have to give immediate consideration to that is because of this fact: If we are going to continue to make available long-

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term credits under lend-lease, then, of course, that throws into disequilibrium all the purposes of the Bretton Woods agreements.

Mr. Eccles. That is right.

Mr. Wolcott. You cannot have your cake and eat it, too.

Mr. Eccles. I would agree with that.

Mr. Wolcott. We have to find out what they are going to do with lend-lease before we give too serious consideration to the Bretton Woods agreements.

Mr. Eccles. That, of course, is referring to the post-war, or what we may term the nonwar assistance.

Mr. Wolcott. Yes, lend-lease was never intended to do anything but to finance this war and help the other nations get the goods to carry on this war.

Mr. Eccles. That is right.

Mr. Wolcott. Surely it was never intended——

Mr. Eccles. If it is a long-term loan, long-term lend-lease program over a period of years, it would supplement the world bank proposal. It would be in addition to it in the furnishing of credit.

Mr. Wolcott. I will put it this way: If there is any supplementing, it is on the part of the bank, that a total of $15,000,000,000 loan directly would be the primary loan and the bank would supplement that.

We have to take into consideration that somebody tells us we are negotiating to make direct loans out of the Treasury in the amount of about $15,000,000,000.

Mr. Eccles. On lend-lease?

Mr. Wolcott. On lend-lease, yes. Then, in addition to that, we are going to increase the capital of the Export-Import Bank by a billion and a half dollars, making available $2,200,000,000. There is a total of $17,000,000,000. Those are the things that are being talked of now, so we can anticipate that the direct loans, when South America comes in for some, possibly, when Belgium and Holland come in for their share of these direct loans, will exceed $20,000,000,000.

Of course, our contribution of $3,175,000,000 to the bank is rather picayunish, and the bank will do nothing but supplement that. We have to know about those things and know about them quickly. Frankly, I do not think that the Foreign Affairs Committee, from my talking with the members, have an appreciation of what is going on in lend-lease. Attempts have been made to call it to their attention, but it seems to me that we, as a Congress, must take some action almost immediately to find out what is going into those lend-lease agreements before we can act on these other matters.

Mr. Eccles. There is an additional inflationary danger, to the extent that we add materially to what will be the post-war domestic backlog demand by the extent to which we create a foreign demand. Certainly, we are not going to be able to meet both the domestic demand and the foreign demand immediately after the war. It seems to me it will be a question of an allocation between the domestic demands or needs, and the foreign demands or needs, so that the amount of money available for foreigners to buy in our market will depend to some extent, I suppose, on the supply of goods we may have available to ship abroad.

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We have to take into account the tremendous backlog of our domestic market for a time.

Mr. WOLCOTT. Here is the thing that is worrying me. You are worried about deficit financing and the effect which deficit financing has upon the value of our currency. We surely have no other way of raising this $20,000,000,000 to make these long-term loans under lend-lease except through deficit financing. It makes it that much more difficult for us to stabilize our own currency so that it will be an influence on the stabilization of other currencies. I am trying to find a way to go along with this, but it seems to me that you are getting all out of proportion if you want to take out of the Treasury of the United States, to finance world rehabilitation, the amount of money that they want. What are they going to use this money for? It is going to be used, of course, for capital goods, producer goods.

I know that right now certain radical leaders in the country tell us that we have to do that, otherwise we are not going to keep 60,000,000 people employed, and already we are commencing to receive letters and telegrams that if we do not do some particular thing, then we cannot put 60,000,000 people to work. We will not have any trouble putting 60,000,000 people to work if we want to speed up our economy to that extent. Perhaps we can put safely to work 55,000,000 employees, and, of course, if we crowd this too much, by putting sixty to sixty-five million people to work, then the post-war depression will come on that much sooner. That is a self-evident fact.

Besides that, the thing that concerns us as much as anything else is, it seems to me, that we are giving a disproportionate amount of consideration to our exports. Our exports, previous to the war, were only about 7 percent of our total production. During World War I, I think we got up to 12 percent for a few years. But it has been as low as 3 percent, and it has never been higher than 7 or 8 percent. We had better use some judgment in this, because, if we are destroying our economy at home, destroying our home markets by the creation of capital goods in foreign markets sufficiently that they, in 7 or 8 years, can compete with us, we are going to be in a grave situation.

In that case, Russia, perhaps, can sell the equivalent of a Chevrolet, Plymouth, or Ford automobile in this country for $500, and we cannot sell it for less than a thousand dollars; it seems to me that we have to think pretty deeply on these things. They are bothering me. I do not know whether they are bothering you or not. But it seems to me that the administration, up to the present time, has been rather superficial to the effect that our foreign policy is going to have eventually on our domestic economy.

Mr. SMITH. Is this not a fact, that the number of jobs that can be created through exports is limited by the amount of imports, unless we decided to give our goods away?

Mr. WOLCOTT. That is what I am trying to get at. Are we deciding to give $20 000,000,000 to foreign countries, with the fact that we gave the rather inconsequential amount of $11,000,000,000 for rehabilitation purposes following the last war, and we are told that we are setting up the international bank for the purpose of avoiding the necessity of having to make direct loans out of the Federal Treasury? That is why I say you cannot have your cake and eat it, too. I think the timing on these loans is terribly bad, if we expect this to go through.

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Mr. ECCLES. It all relates to this question of inflation. There is no question about it. I think it is apparent to this committee that inflation comes from increasing purchasing power through deficit financing beyond our ability to produce goods and services to meet the demand, and so long as the war lasts, that pressure will increase. With the post-war there will be a very great backlog demand of everything in our own country, as well as throughout the world, and as to our ability to meet our own demands in relationship to the purchasing power which will exist here, which will be almost unlimited, for the first few years, and also to meet the foreign demand, I agree with Mr. Wolcott that we have to determine to what extent we are going to meet the foreign demand and to what extent we are going to meet the domestic demand; also how we expect to pay for the meeting of such foreign demand that we expect to meet.

There is already more than $20,000,000,000 held by the foreign countries in the form of dollars, currency and gold, short-term American securities, so that without further credit, to the extent that they use the gold and the balances and the short term American securities that they own, they have the purchasing power at any time that we are willing to provide shipping space and to issue export licenses.

That would be supplemented by any post-war lease-lend that was extended and would be further supplemented by such loans as may be made from the Export-Import Bank. It would be still further supplemented by such loans as may be made from the international bank, as proposed in the Bretton Woods agreement.

We cannot meet all of the world's demands, certainly not immediately; not even our own demands. It will take us several years to get caught up in our own automobile demands alone, and in the demands for many other consumer durable goods. Our housing demands will not be met for a good number of years. It seems to me that we have to make up our minds, if we are going to prevent an inflationary development after the war, to realize that there is a limit to our ability to meet all demands. We are finding today that the demands of war have greatly restricted our ability to meet all civilian requirements, and although we are meeting them fairly well, we are living upon our fat, so to speak. We are using the automobiles that we have had for a long while, using clothing that we have had for a long while, and the same with furniture and a great many other things. We are getting by as we are because we were so well stocked and so well supplied with consumer durable goods, with housing and with other articles, such as automobiles and clothing. It is due to that fact that we have been able to get by as we have and that our standard of living has been maintained as well as it has, at the same time we have been able to do what we have toward the war effort.

It is apparent, I think, to all of us that there are increasing inflationary dangers. Not long ago, in the bottom of the depression, I said that a $50,000,000,000 debt did not concern me and it was shocking to most people. But we will now have to meet the $300,000,000,000 structure.

Mr. WOLCOTT. Do you not think that bothered us then because we expected to pay it back? Now we are beyond any hope of ever paying this debt back, so we do not care.

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Mr. ECCLES. I had never thought of paying it. I thought of servicing it and refunding it, which is always a process of debt structure.

Mr. MONRONEY. It is a little easier to service a two- or three-hundred-billion-dollar debt account on a national income than a smaller debt when you are——

Mr. WOLCOTT. Wait a minute. We have to raise $3,000,000,000 to service this debt so that fixes that argument.

Mr. ECCLES. We will have to raise more than that. We will have to raise four or five billion if your debt gets up to $300,000,000,000.

Mr. WOLCOTT. That would be very conservative.

Mr. ECCLES. I do not think that a $300,000,000,000——

Mr. WOLCOTT. I think we should get that definitely on the record. It is your opinion that if the national debt reaches $300,000,000,000, that it will take $5,000,000,000 a year to service it?

Mr ECCLES. That is just a rough——

Mr. WOLCOTT. Between four and five, I believe you said.

Mr. ECCLES. Of course, that can vary, depending on how much the Treasury finances in the short-term field. I have felt that they have financed too much of it, especially that part that was financed by the banks, in higher interest-bearing securities. That increases the cost of servicing the Treasury's outstanding debt.

Mr. WOLCOTT. On the basis of $300,000,000,000 of debt, would you say the carrying charges would be——

Mr. ECCLES. I would say around $5,000,000,000.

Mr. WOLCOTT. $5,000,000,000?

Mr. ECCLES. Yes. You see, that is about one and three-quarters percent. The $300,000,000,000 debt in and of itself does not necessarily create inflation. The greater the public debt, the more difficulty there is in managing the debt, and avoiding inflation, because where it is financed, as this debt has been, by the banking system, the amount of currency and the amount of demand for checking-account deposits is very, very great. They are four times greater than they were here, I think, in about 1940. They are going up rapidly. Add to that the ownership of Government securities and you have a stupendous figure. If the public undertook to spend that money, convert those Government bonds into money so that they could spend it, inflation could be very rapid if you did not have controls.

The controls are necessary to assure the public that you are not going to let inflation develop. Otherwise, with that huge volume of funds available, a temporary demand in excess of our ability to meet that demand could be created all at once.

Mr. WOLCOTT. It might cost us conceivably 3 percent or $9,000,000,000, to service the $300,000,000,000.

Mr. ECCLES. I think that that is controllable; I would not think that is conceivable. The question of the interest rate is a manageable thing that the central banking operation can definitely manage within certain limitations.

Mr. CRAWFORD. Mr. Chairman, may I ask Mr. Eccles a question on a point he brought up a moment ago?

You spoke about $25,000,000,000 claimed to be held by the foreign countries against us, against earmarked gold, short-term securities, and currency.

Mr. ECCLES. And gold which is not earmarked which they hold abroad.

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Mr. CRAWFORD. That is right. Which they can convert into dollars by reason of our gold-buying policy.

Mr. ECCLES. That is right.

Mr. CRAWFORD. In the last bulletin here, we find about $25,000,000,000 in circulation. That is mostly in large denominations, is it not?

Mr. ECCLES. To a larger extent than I like to see.

Mr. CRAWFORD. We have this black-market operation, which moves into this inflationary aspect. Naturally, I should think the black-market operator would carry just as few records as possible, and would deal in currency on every occasion. If I were operating the black market, that is the way I would operate it, at least. Then I would move into bigger and bigger bills, as my buying power accumulated. Would you care to comment on that general problem as related to the purposes of O. P. A. and their difficulties down there in handling some of these black-market operations?

Is there anything we can do with respect to the amount of currency in circulation to help O. P. A., or to head off more of their inflation, in currency, whether it is held by people of other countries or by our own people?

Mr. ECCLES. I think it is largely held by our own people. There would naturally be some of it held abroad. I think, for instance, the Germans have accumulated money outside of the country, and I think there has been a general feeling throughout the world on the part of practically all nationalities that the dollar was about the safest place to put their money, to the extent that they have been able to make transfers. Exchange control has made transfers very difficult for a long while. But, there is no question that a certain seepage has gone on and that some of this currency is held by people of foreign nationalities, for the purpose of security for themselves, but not for black-market operations.

I think there was some of it, of course, that the Germans and Japs held for the purpose of sabotage, but I would think the amount would be very small. The biggest part of the currency that you refer to, which is the large bills, is held by tax evaders and black-market operators within our own country, and there is no question but what there is a considerable amount of tax evasion and a considerable amount of black-market operations.

Had it not been for the O. P. A., I do not know what would have happened. It seems to me that we are a little mild in dealing with tax evaders and black-market operators. There are too many holes in the tax laws that possibly could be tightened. I know that the Bureau of Internal Revenue, with the increase in taxpayers from five million to forty or fifty million, at a time when the manpower situation has been getting more acute, has had an almost impossible job to do. Due to that, I suppose their inspections and checks have not been as thorough and as complete as they would like to make them.

But, I think that more severe punishment of both black-market operators and tax evaders would be extremely helpful. I think that it is only fair to the honest citizen, and certainly to our boys in the service, that people who, at any time, but particularly in wartime, engage in black-market operations and tax evasions, be punished. It is difficult to conceive how you could treat them too badly.

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Mr. CRAWFORD. Is there any means whereby we could get at that type of operator who holds the large bills?

Mr. ECCLES. I have suggested ways in which they might be gotten to. We have discussed it, as a matter of fact, with the Treasury. I know that it is conscious of the problem and there has been considerable discussion of it. We have discussed means that would, without question, bring in all the big bills. There is, of course, the question of to what extent that might stop the operation, because if they could not get five-hundred-dollar bills, or thousand-dollar bills, they would get hundred- or fifty-dollar bills. If they could not get those, they would get twenty-dollar bills. I do not believe that alone would stop it. It would make it a little less convenient. You could get rid of big bills, just as you made people turn gold in. Your could provide that all bills over a certain amount be taken out of circulation and exchanged for smaller bills, and the owners could be required to turn them in by a certain date. The bills could be depreciated at a rate of so much per month after that date. The holders would come in to turn the bills in, and when they appeared, you could take them to a bank or Federal Reserve bank and have them sign them under oath. In that way you would at least find out who owned these big bills.

You would stop the circulation in a hurry, and you would find the owners, plus the fact that you might put a little fear of God into the people who are accumulating them and evading taxes. I do not know that it would stop it, but it would certainly make them stop and look, temporarily.

Mr. CRAWFORD. It would give the Treasury a pick-up point, would it not, as to where to start any investigation which they might want to do?

Mr. ECCLES. It would give them a pick-up point. There is no question about it.

There is another thing that I have suggested in answer to this question and I do not mean to say that my suggestion was original or new, something that the Treasury had not thought of. At least it has been discussed with them. That is, requiring every taxpayer to file, with his tax return, each year, a statement showing his assets and his liabilities, so that changes from year to year could be reconciled. In time, people would likely get caught if they were not reporting their income, because as they invested in stocks or in bonds, or in property, it would show up at a later date. The question would be, Where did you buy the bond, or where did you buy the stock?—because you had not shown that you had received income enough to make that purchase.

The British have used that system for a good many years, requiring the taxpayer to file a statement each year of assets and liabilities. That would be a help, I think, in stopping the tax evasion.

The CHAIRMAN. Mr. Eccles, is it not assumed that we have definite commitments to make immense loans to our allies in the post-war period? What do you know about that?

Mr. ECCLES. I do not know a thing about it. We are never consulted with reference to any matter of that sort. It is entirely outside of our field. We have nothing whatever to do with either the Treasury operation or lend-lease operation, or State Department operations that involve foreign credit or foreign disbursements of any kind. We

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know nothing about it and we are never consulted about it. We have no information on the subject.

Mr. SMITH. Mr. Chairman, I have a question.

The CHAIRMAN. Mr. Smith.

Mr. SMITH. I am wondering how you determine the relative amounts of paper currency held by foreign nationals, and by black-market operators.

Mr. ECCLES. We do not.

Mr. SMITH. You do not really know?

Mr. ECCLES. We do not know. We can just guess at it.

Mr. SMITH. I understand that you believe the time is approaching when the Government must adopt a policy of rigidly limiting deficit financing.

Mr. ECCLES. Will you ask that question again?

Mr. SMITH. You believe that the time is rapidly approaching when the Government must adopt a policy of rigidly limiting deficit financing?

Mr. ECCLES. I do not believe it is possible, during the war period, to approach a balanced budget. I do not believe that at this late stage in the war development that the American public would stand for increased taxes or that Congress would impose them. They are talking about, the need of decreasing taxes to encourage individual initiative, to give employment after the war, which I think is very premature. As long as the war goes on, there should be no talk about decreasing taxes. We are willing to give the Army and Navy almost a blank check, and lease-lend; certainly it is apparent that you are going to have a very large deficit and there is nothing that is likely to be done about it.

Mr. SMITH. I was not speaking about the war period particularly. Let us take the period that follows the war. It is your idea that the Government should adopt a policy of rigidly limiting deficit financing?

Mr. ECCLES. It is certainly my view that that is what they should do. Nothing would be more helpful in preventing an inflationary development than to decrease the military expenditures to the bone, as far as it is possible to go. After all, they make up 85 or 90 percent of all expenditures, and they should be limited and restricted very greatly; taxes should be held high. Otherwise, we cannot talk about even approaching a balanced budget if we talk about reducing taxes as we reduce public expenditures, because you still leave the gap, and I would say cut the expenditures and maintain the taxes.

Mr. SMITH. The time will come——

Mr. ECCLES. I do not mean exactly in the present form, but I mean taxes that will give this country around thirty to thirty-five billion dollars of revenue, and not $18,000,000,000 of revenue.

Mr. SMITH. Deficit financing is ultimately self-limiting anyway, is it not?

Mr. ECCLES. I suppose, if it were large enough, and it continued long enough, it would be, but I am unable to say. I do not think anybody can say just how much deficit financing we can have, and how long it can run without creating an uncontrolled inflationary condition.

Mr. SMITH. The reason I say that is because of the experiences the world has had with deficit financing, which seem to prove that. Take Germany for an example, their deficit financing finally ran out.

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Mr. ECCLES. Yes; but they did not impose taxes. During the period of the twenties, after the last war, they had run a huge deficit financing without controls. They had, as you know, a very great foreign reparation debt imposed upon them after the last war. The German situation is in no way comparable to our situation.

Mr. SMITH. I do not know whether you consider it comparable to ours or not, but they went through the process of deficit financing and they ultimately burned themselves out.

Mr. ECCLES. Whose situation is that?

Mr. SMITH. Russia.

Mr. ECCLES. Russia had a revolution and they just repudiated everything that had gone before.

Mr. SMITH. Was the revolution not largely caused by deficit financing?

Mr. ECCLES. No. I think the revolution was far deeper than any deficit financing.

Mr. KUNKEL. A more comparable instance might be that of France, do you not think so?

Mr. ECCLES. I am not enough of an authority on the history of inflations to know what the causes of each one of the inflationary periods happen to be. But, I do know that an inflation can only be brought about when the means of payment in the hands of the public and their willingness to spend that means of payment exceeds the supply of goods available to the market. Whether it is France or Germany, or any other country, that is so. If they continue to expand bank deposits, whether it is done by the issuance of currency or by an interest-bearing security, inflation will be the result.

Germany financed her situation by issuing Government bonds to whatever extent was necessary, and the private banks bought the bonds so they created the deposits just like we are creating them right now.

.Mr. KUNKEL. That is what I was going to say. That is similar to what we are doing.

Mr. ECCLES. That is right, but in doing that, the goods and services were certainly not available to the public to buy. They were a huge debtor to the rest of the world. They did not have access to the raw materials, productive facilities to utilize their manpower, and to meet the economic problems with which they were confronted, so that they got an increase in the means of payment far in excess of their ability to meet the demand. They should have restricted the deficit financing. They should have held it down. There may be some truth in the statement that they did it deliberately. As we all know, the German marks were sold throughout the world on the way down, and they got a good many million dollars in foreign exchange, that was helpful to Germany, and the foreigner that bought the mark, of course, lost everything.

They did that to a great extent. I do not know to what extent it was deliberate, but there was no real need of it. There is no need of inflation here. If we keep our controls on, and we do as Dr. Smith says, as soon as this war is over; if we could curb expenditures even before the war is over and take a better look at what we are spending, be conscious that we do have a deficit and restrict it to whatever extent we can restrict it, it will be helpful and it is certainly desirable. It

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is not only desirable, but when the war is over, it will be necessary, to greatly reduce this deficit and to bring our Budget within balance, as nearly as possible, as soon as we possibly can.

Mr. Talle. Mr. Chairman.

The Chairman. Mr. Talle.

Mr. Talle. Has the Federal Reserve System cooperated with the Treasury and the War Department in the issuance of invasion currency?

Mr. Eccles. No; we have never been consulted about it.

Mr. Smith. Mr. Eccles, have you figures with you showing the amount of direct Government obligations held by the commercial banks at the present time?

Mr. Eccles. Yes; it is more than $75,000,000,000.

(The following information was later submitted by Mr. Eccles:)

Washington, *March 5, 1945.*

Hon. Brent Spence,
Chairman, Banking and Currency Committee,
House of Representatives, Washington, D. C.

Dear Mr. Chairman: When I testified before you committee this morning, I was asked by Mr. Smith, of Ohio, to put in the record a figure of the total holdings by commercial banks of direct obligations of the United States Government, as well as obligations guaranteed by the Government. The best estimate we can get as of December 31, 1944, is $77,500,000,000. Holdings of United States Government obligations by the Federal Reserve banks on the same date were $18,800,000,000.

Very truly yours,

M. S. Eccles, *Chairman.*

Mr. Smith. Does that include the last bond sale?

Mr. Eccles. Yes; the last sale was in December.

Mr. Smith. Would you put the figure in showing the amount of securities also held by the Federal Reserve System?

Mr. Eccles. I can give that to you now.

Mr. Smith. That is about $18,000,000,000, is it not?

Mr. Eccles. That is approximately nineteen and a quarter billion dollars.

Mr. Smith. Then put in also the amount of indirect Government or guaranteed obligations held by the commercial banks.

Mr. Eccles. I think we include those in the other figure. They are negligible. The amount of guaranteed Government obligations is a negligible factor.

Mr. Smith. About four or five billion dollars?

Mr. Eccles. Are you speaking of bonds or loans that are guaranteed?

Mr. Smith. For instance, home-owners' loan bonds are considered indirect obligations, are they not?

Mr. Eccles. Yes; but they are considerably less than $2,000,000,000.

Mr. Smith. I merely wish to have them included.

Mr. Eccles. All right; we will include all Government direct and indirect obligations owned by the commercial banks as of the end of the year.

Mr. Smith. Thank you.

The Chairman. Are there any further questions? If not, you may stand aside, Mr. Eccles.

Mr. Engle, Representative from the Second District of California. desires to make a short statement.

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Mr. ECCLES. There is just one thing, Mr. Chairman. The last time I appeared before this committee I think Mr. Monroney asked that we put certain information in the record.

Mr. MONRONEY. It was on the use of collateral in discounting?

Mr. ECCLES. That is right. We have that material here in the form of four questions and answers, so I will give it to the reporter to put in the record.

The CHAIRMAN. It may go in the record at the conclusion of your statement. That concludes your statement, Mr. Eccles?

Mr. ECCLES. That concludes my statement.

(The information referred to above is as follows:)

Q. 1. What is the average rate of interest on bank holdings of United States Government securities?

A. The average return received by commercial banks on their holdings of United States Government securities was slightly under 1.5 percent during 1944.

This average is an estimate based on the member bank earnings and dividends reported related to condition report figures and on the Treasury survey of United States Government security ownership. It represents an average yield rather than the average coupon rate. The average coupon rate may be slightly higher because of securities purchased at a premium.

Q. 2. What is the average rate of interest on the total United States debt outstanding?

A. The average annual rate of interest on the total interest-bearing debt of the United States outstanding on December 30, 1944, as computed by the Treasury was 1.916 percent. (Treasury Bulletin, February 1945, p. 27.)

Q. 3. What is the volume of V-loans outstanding?

A. The volume of war production loans guaranteed under Regulation V outstanding on December 30, 1944, was $1,736,000,000. (Federal Reserve Bulletin, February 1945, p. 145.)

Of the $1,736,000,000 outstanding, the portion guaranteed amounted to $1,482,-000,000. The additional amount available to borrowers under guaranty agreements outstanding was $4,454,000,000.

Q. 4. What is the amount of commercial paper discounted at the Federal Reserve banks since 1930?

A. The volume of discounts and advances outstanding at the Reserve banks at the end of each half year since 1930 is shown in the following table:

End of month figures, in millions of dollars

	Rediscount of or advances secured by—		Total		Rediscount of or advances secured by—		Total
	Eligible paper	U. S. Government obligations			Eligible paper	U. S. Government obligations	
1930—June	163	108	272	1938—June	1	6	7
December	162	89	251	December	1	2	3
1931—June	102	47	149	1939—June	3	2	5
December	317	321	638	December	6	1	7
1932—June	264	157	421	1940—June	1	1	2
December	159	61	220	December	2	1	3
1933—June	104	34	138	1941—June	1	1	2
December	51	27	78	December	1	2	3
1934—June	13	5	18	1942—June	2	2	4
December	2	3	5	December	3	3	6
1935—June	2	3	5	1943—June		5	5
December	1	2	3	December		5	5
1936—June	2	1	3	1944—June		13	13
December		2	2	December		80	80
1937—June	2	7	9				
December	3	6	9				

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Any note, draft, or bill of exchange is eligible for discount at the Federal Reserve banks (or as security for an advance) provided: (1) it has a definite maturity of not more than 90 days at the time of discount, except agricultural loans which may have a maturity of 9 months; (2) it has been issued or drawn for an agricultural, industrial, or commercial purpose; (3) it was not issued or drawn for the purpose of carrying or trading in stocks or bonds except United States Government obligations; and (4) it is endorsed by a member bank.

The peak amount of discounts and advances outstanding at the Reserve banks was reached in the last quarter of 1920. At the end of December 1920, discounted eligible paper amounted to $1 578,000,000 and discounted paper secured by United States Government securities totaled $638,000,000.

The CHAIRMAN. All right, Mr. Engle.

STATEMENT OF HON. CLAIR ENGLE, REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. ENGLE. Mr. Chairman, I'm going to try to be very brief because I know it is getting late, and with your permission I would like to make a brief statement and supplement it with a statement for the record.

The CHAIRMAN. Yes.

Mr. ENGLE. I wanted to come before the committee to tell you we held an informal meeting with a group of western Congressmen Saturday, who are very much concerned with the reduction of the gold reserves from 40 to 25 percent. The group is not in agreement on this bill, and wants to examine some of the possible alternatives to it.

However, they did not agree on what those alternatives might be, but did authorize me to come before this committee and present two amendments, which would make the bill much less unpalatable to them.

Number one amendment is that the duration or the reduction from 40 percent or a percentage below that, be for a fixed period of time, or for the duration of the emergency. For instance, for 2 years, so that at the end of that time the reserve will automatically go back to 40 percent unless the Federal Reserve Board appears before this committee and the committee of the other House to have the time extended.

Number two amendment is that the committee consider the suggestion made by Mr. Burgess to limit this reduction to 30 percent rather than 25 percent, and possibly, the suggestion made by Senator Taft, on the other side, to limit it to 35 percent. In other words, come down 5 percent at a time.

The reasons for these two suggestions are these:

In the first place, with reference to the 30-percent or 35-percent reduction, it has been stated by Mr. Burgess before the Senate committee, and I presume before this one, although I did not hear his testimony, that a reduction to 30 percent will take care of the needs of the country for currency expansion for some time to come, and would be adequate. In fact, he suggested a serious consideration of that figure, and if that is adequate, that is as far as we should go.

With reference to the time limitation, we have felt that this is a matter which is brought on by the war emergency, and therefore should only last for the duration of the emergency, and that this is a matter which should be subject to the continuous review of this committee and the committee of the Senate, so that at a future time, spe-

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cifically, the Federal Reserve Board will come before this committee for a review of the entire situation.

Otherwise, the reduction which is proposed in this bill, as I understand, will be permanent, to 25 percent. We want to see it go back, automatically, at the end of a specific period of time, unless there is reason shown why it should not return after a specific lapse of time. If that does not occur, then it means that we would have to put in a special bill or special legislation to get it back to its former pattern.

We are particularly concerned, also, and we cite this as a reason for asking the committees of Congress, in effect, to keep constant watch over this situation—we are concerned about the fact that the Federal Reserve Board is operated by Mr. Eccles, who definitely has stated before this committee, and also before the committee of the Senate, that he does not believe in a gold reserve.

We do not think Congress will go along with him on that belief. He stated before the Senate committee that this 25-percent reserve was just a concession to orthodoxy. We do not agree with that and we do not think that Congress would agree with it. We are disturbed over the fact that the administration of this monetary program is in the hands of someone who, from a standpoint of philosphy, is so basically in disagreement with some of those of us who represent the mining areas in this country.

That is the substance of the statement I have to make at this time, and with your permission, Mr. Chairman, I would like to file a supplementary statement.

The CHAIRMAN. It may be incorporated in the record.

Mr. SMITH. Mr. Engle, you believe then that there is a relation between gold and our currency—a definite relation?

Mr. ENGLE. That is correct, and I think that, generally speaking, the group, which met informally Saturday, believe in a gold reserve and believe in a gold base for our currency. They are the ones who are disturbed because of these statements made in the record of the hearing over in the Senate, at least, which I have read, by Mr. Eccles and we do not want those statements to go unchallenged. We want to be on record as opposing that philosophy so far as our monetary system is concerned.

Mr. SMITH. In other words, there is more to it than the idea of it just being orthodox and psychological?

Mr. ENGLE. That is correct. I think an examination of history would show it, and I think the question asked by Mr. Hull, here, was a very good question, in which he asked Mr. Eccles to cite a single instance, if he could, in our history, in which a currency which was not based upon gold or tied to a metallic basic of some sort, did not eventually end in disaster.

Mr. WOLCOTT. Mr. Buffett asked that question.

Mr. ENGLE. Mr. Buffett, yes, I beg your pardon.

The CHAIRMAN. If there are no further questions, the committee will adjourn.

(Whereupon, at 12:30 p. m., the committee adjourned.)

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(The following statement was later received for the record:)

SUPPLEMENTAL STATEMENT OF HON. CLAIR ENGLE, REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

The two proposed amendments discussed before the committee were agreed to by the western Congressmen interested in mining as desirable in the event the bill under discussion is voted out. These Congressmen do not necessarily support the bill, and personally I am in hopes that the committee will carefully consider the possible alternatives to reducing the gold reserve.

One of these alternatives is a bill (H. R. 2343) introduced by me in the House to raise the price of gold to $56. Similar bills were introduced by Senator Scrugham and Senator McFarland in the Senate and Congressman Harless in the House.

The figure of $56 per ounce increase in the price of gold is arrived at by increasing the value of our gold in precisely the amount necessary to allow the same expansion of currency as will be permitted by a reduction of the reserves from 40 to 25 percent.

Inasmuch as the bills do exactly the same thing so far as meeting the necessity for currency expansion, they are equal on that ground.

The relative merits of the two proposals, aside from the fact that they both provide the necessary currency expansion, have been discussed to some extent in this committee and a great deal before the Senate Committee on Banking and Currency.

It is claimed that raising the price of gold is more inflationary than reducing the gold reserve. However, since both measures provide for exactly the same currency expansion, it is difficult to see how one would be more inflationary than the other.

Mr. Eccles has stated as an objection that increasing the price of gold would be giving foreign gold holders a present of 8½ billion dollars. The increase in the Treasury in gold would be $12,000,000,000. The net gain would be some 3½ billion dollars. It is hard to understand why we should worry about increasing the money in the hands of foreigners for trade in this country when we are spending billions of dollars in lend-lease and racking our brains for ways and means to put the foreign countries back on their feet in the post-war period.

An increase in the price of gold will increase the gold production and will thereby make stronger and more favorable the position of this country from a monetary standpoint. Since our basic difficulty is a shortage of gold in proportion to the total amount of currency in circulation, the solution should work toward getting more gold into the United States Treasury, rather than less. The basic objection which the people who believe in a gold standard have to the proposal to reduce the gold reserve from 40 to 25 percent is that it is a move in the wrong direction. We know that Mr. Eccles and some of the people in the Treasury Department do not believe in a gold standard and want to get us completely off the gold standard as soon as they can. The proposal of this bill is a step in that direction. Later they will ask for a reduction from 25 to 15 percent, and finally that the gold reserves back of our currency be abandoned altogether.

It is very apparent that the people who do not believe in a gold backing for our currency are gradually, step by step, pushing us into a position of not having any metallic backing behind our currency. When they reduce it to 25 percent, then there will be some reason to reduce it 5 percent and eventually they will convince the people of the country that they do not need anything behind the currency at all. We should reverse the situation and take the stand that we must have gold behind our currency in order to keep it stable not only throughout this country but throughout the world. The proper method of doing that is to secure more gold than we have now, instead of letting them push us inch by inch away from the gold standard. The way to get at it is to maintain the ratio that has been so successful ever since the gold Federal Reserve System came into existence in 1913, and to advance the value of gold. We should not join them in this march away from gold backing. It is going to be very difficult to turn around when we find it necessary in the future to do so.

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(The following letter was later received for the record:)

THE AMERICAN MINING CONGRESS,
Washington, D. C., March 8, 1945.

Re H. R. 2124.

Hon. BRENT SPENCE,
Chairman, Committee on Banking and Currency,
House of Representatives, Washington, D. C.

DEAR MR. SPENCE: The American Mining Congress has given careful consideration to the legislation pending before your committee under which the minimum gold reserve requirements against Federal Reserve notes and deposits would be reduced to 25 percent. We believe this proposal, which constitutes a departure from a principle adhered to for over 30 years, is of serious concern to our future monetary policy and the stability of our currency.

In the event your committee concludes that a reduction in the reserve requirements is imperative at this time, we respectfully urge—

(1) That such reduction be limited to a 2-year period, at the termination of which the existing gold reserve requirements, of 40 percent against Federal Reserve notes and 35 percent against deposits, will be automatically restored.

(2) That any reduction at this time be limited to 30 percent.

Since a reduction in the gold reserve requirements is proposed as a result of emergency conditions arising from the war it is fitting that the term of such reduction be limited to a fixed period. Many precedents for such a limitation exist in recent wartime legislation, as well as in the monetary legislation of the past decade. If at the end of 2 years the emergency has passed such a measure as you are now considering should be allowed to expire. If the emergency still exists, we submit that a matter of such great public importance should be subject to review by the Congress to determine what action may then be required. In either case, the long-established 40-percent and 35-percent requirements should be maintained as a part of our parmanent monetary structure; any departure from them should be temporary only and should not be enacted in the form of permanent legislation.

Reduction of the reserve requirements to a figure no lower than 30 percent is in accord with testimony by Mr. Eccles to the effect that a 30-percent minimum requirement would take care of any foreseeable contingencies through at least 1946. We see no valid reason at this time for going beyond the needs of the next 2 years.

Basically, we believe in a sound monetary system, with adequate metallic backing. Reduction of the gold reserve behind our money is a step toward a managed currency with all its evils, and away from sound and tested monetary principles. We should go no further in this direction, and for no longer a period than absolutely necessary. We disagree strongly with the view of Mr. Eccles that a gold reserve is "a concession to orthodoxy" and that the pending legislation is a "technical matter," on which the Treasury had been consulted but as to which "nobody else would be familiar with it or would be interested in it." We submit that this legislation is of the most far-reaching consequence to the future economy and prosperity of our country, that the utmost caution should be observed, that if we go through a red light set up by the Congress and scrupulously observed for 30 years, we should keep the brakes in sound working order. We should not, under the stress of emergency, take any action that might disturb confidence in the integrity of the American dollar, or jeopardize the protection to our currency afforded by an adequate gold backing.

Very respectfully yours,

THE AMERICAN MINING CONGRESS,
JULIAN D. CONOVER, *Secretary.*

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