UNREVISED COMMITTEE PRINT

PRICE-CONTROL BILL

HEARINGS

BEFORE THE

COMMITTEE ON BANKING AND CURRENCY
HOUSE OF REPRESENTATIVES

SEVENTY-SEVENTH CONGRESS

FIRST SESSION

ON

H. R. 5479

A BILL TO FURTHER THE NATIONAL DEFENSE AND SECURITY BY CHECKING SPECULATIVE AND EXCESSIVE PRICE RISES, PRICE DISLOCATIONS, AND INFLATIONARY TENDENCIES, AND FOR OTHER PURPOSES

PART 19

SEPTEMBER 29, 1941

Printed for the use of the Committee on Banking and Currency

UNITED STATES
GOVERNMENT PRINTING OFFICE
61493 WASHINGTON : 1941

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PRICE CONTROL BILL

MONDAY, SEPTEMBER 29, 1941

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

The committee resumed hearings on the price-control bill at 10:20 a. m., Hon. Henry B. Steagall (chairman) presiding.

Members present were as follows: Messrs. Steagall, Williams, Spence, Ford, Brown, Patman, Gore, Mills, Monroney, Lynch, Boggs, Hull, Crawford, Kean, Miss Sumner, Messrs. Smith, Kunkel, Rolph, and Dewey.

The CHAIRMAN. The committee will come to order.

We have Mr. Eccles, Chairman of the Federal Reserve Board, who is, of course, well known to the members of this committee.

We are very glad to have you with us, Mr. Eccles, and I assume that you have a prepared statement that you would like to submit, and if so, the committee will be glad to defer to your wishes in that regard and permit you to make that statement without interruption.

I have an idea that later the members of the committee will desire to interrogate you somewhat.

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

Mr. ECCLES. Mr. Chairman and members of the committee, I have prepared rather a brief statement. I have been away for some little time, and just returned at the end of the week, so the statement that I have is brief, and is not all-inclusive.

The members of this committee are, I think, somewhat familiar with my views, and that might be an excuse for my not preparing a more elaborate statement. I will undertake to read what I have.

In appearing here today at the committee's request, I should like to make a brief statement of my personal views as to the part that price control has to play in any adequate Government program for dealing with price inflation. I have not had an opportunity to prepare a comprehensive statement covering the many aspects of this important subject but on various occasions I have undertaken to set forth my own views on the problems of combatting inflation as well as deflation, and this committee, both in these hearings and in the past, has already covered so much of the ground that it is not necessary to take your time in traversing it again. Such aspects of the subject as you may wish to have me discuss can be brought out in your questions.

It is desirable from my standpoint, however, to outline briefly the framework as I see it, into which the pending bill fits as a part of a broad, integrated Government program to deal with inflation. You are all aware that price inflation threatens to develop with accelerating rapidity because our vast defense expenditures are putting buying power into the hands of the public at a faster rate than goods can be turned out to satisfy both the increasing civilian demand as well as our expanding defense requirements. We know that this condition is bound to become increasingly acute as more and more of our productive capacity is devoted, as it must be, to supplying defense rather than civilian requirements. There is no need to remind this committee of the consequences of an uncontrolled inflation. You are fully cognizant of its ruinous effects upon the entire economy and particularly upon labor, the farmers and the great mass of our working population. Nor is it necessary to emphasize to you that the first line of attack upon the problem is to increase production to the greatest possible extent.

That is why it is so urgent, in the national interest, that we utilize all of our productive machinery, the smallest as well as the largest units, and all of our available man power in producing continuously first for defense, because our national safety depends upon it, and secondarily for civilian needs. For this reason industrial strife, and the attempt to settle dispuates by the methods of lock-outs and strikes, are intolerable in time of national peril.

Mr. PATMAN. Read that over again, will you, please?

Mr. ECCLES. For this reason, industrial strife, and the attempt to settle disputes by lock-outs and strikes, are intolerable in times of national peril.

Yet we know that successful as we may be in using our productive resources fully, acute shortages of civilian goods are inevitable in more and more lines. We have already encountered scarcities of many basic metals and other strategic materials, and we have not yet begun to feel the pinch. Beyond a point we cannot produce more and more goods both for defense and for civilian consumption. Our national security requires that our civilian population forego at this time many goods that, however desirable, are not essential. Fortunately our abundance of the necessities of life is so great that our people are not obliged, like our allies and their enemies, to go on food and clothing rations. Nevertheless we have got to get along with fewer durable consumers' goods that use materials essential for defense. We have got to realize, far more than we do as yet, that we must be prepared to postpone buying of civilian goods which cannot be produced in sufficient quantity at this time to meet the rising demand. When the emergency is over and production can again be turned to supplying civilian wants the deferred demand will be an important factor in offsetting a post-defense slump.

For the present, however, the most important aim of public policy on the economic front, next to procuring maximum production, is to dampen civilian demand for goods which cannot be produced in sufficient quantities. We cannot leave this to chance or to voluntary action on the part of the buying public. The inescapable result of letting the situation take care of itself would be a price inflation of staggering proportions and demoralizing effects upon our economic system. The situation can only be dealt with effectively by a coordinated and comprehensive series of Government measures of which the bill you are considering is an essential integral part.

The means available to the Government for dealing with the problem fall into two broad categories—general over-all or broad functional controls, on the one hand, and selective controls on the other. Taxation, fiscal, and monetary policy belong in the category of over-all, functional controls. Price fixing, priorities, regulation of consumer credit are necessary supplemental controls that are selective in character.

It has been my view for a good many years that in formulating and carrying out Government economic policy to deal with either inflation or deflation we should rely first of all upon the broad, over-all functional controls. They operate on the economy as a whole, indirectly rather than directly; they are in keeping with democratic processes, and give private enterprise and initiative the fullest possible scope consistent with the general welfare; they serve to create a climate favorable or unfavorable, as conditions may require, for expansion or contraction. They are our main reliance now, and I believe properly so. But they are not enough. They need to be supplemented by such direct measures as are necessary to reach conditions arising from shortages. The pending bill is the most important measure of direct control, and should, in my judgment, be sufficiently broad and flexible to allow for wide administrative discretion in dealing with future contingencies.

The point that I desire to emphasize, however, is that the economic area to which we must apply direct controls depends in large part upon how promptly and effectively we use the functional measures to draw off buying power—and at the same time help pay for defense. If Congress fails to enact adequate tax legislation, particularly corporate and individual income taxes, as well as excise taxes on scarcity goods; if we leave the credit doors wide open, so that bank credit and consumer credit continue to expand; if our people indulge in buying sprees instead of conserving their funds—and there is no better way than by subscribing to defense bonds—then the only alternative is to widen continually the area to which direct controls must be applied if we are to avoid a ruinous inflation. Such controls as are proposed in the bill before you are vitally necessary to reach scarcity conditions, if prices of civilian goods and the costs of defense are to be held within reasonable bounds.

I am fully in accord with the objectives of taxation policy which the Secretary of the Treasury declared when he presented his tax program to Congress; I believe that the Government program for dealing with inflation approaches the problem from the right end—though we have done too little too late so far. I do not believe that we should approach the problem from the other end by blanketing the economy with direct controls first, and applying over-all, functional controls secondarily. I see no good reason for attempting the impossible task of repealing the law of supply and demand altogether, of undertaking to police not merely those prices which have to be policed because of scarcities, but all prices, the bulk of which do not need to be policed. I would leave the problem of how far price control should go in the hands of one administrator, giving him ample jurisdiction and discretion.

Whether or not you include within the terms of this bill a declaration of policy or discretion to deal with labor and farm prices, the fact is that you cannot leave wages and salaries which are the main factor in prices to rise indiscriminately and be realistic about preventing inflation. You cannot, in my judgment, realistically put a high-level floor under farm prices and no ceiling.

The bill before you should be promptly enacted.

That is my statement.

Mr. GORE. Would you mind reading that last paragraph again?

Mr. ECCLES. Whether or not you include within the terms of this bill a declaration of policy, or give discretion to deal with labor and farm prices—and I am not advocating that you do that; as I understand it, Mr. Henderson does not want this bill to be all-inclusive in this field, but the fact is that you cannot leave wages and salaries, which are the main factors in prices, to rise indiscriminately and be realistic about preventing inflation.

The CHAIRMAN. Mr. Eccles——

Mr. ECCLES. Just a moment, please. You cannot, in my judgment, realistically put a high level floor under farm prices, and have no ceiling.

The CHAIRMAN. You would not advise that the legislation should undertake to set aside any of the benefits to agriculture or to labor embodied in legislation already enacted and which represented the legislative purpose directed at each of the problems, independent of the present emergency, would you?

Mr. ECCLES. I would not advocate that the floor be taken off at this time on farm prices. There are some agricultural prices that have not felt the inflationary effects of the defense program, as other agricultural prices have. You have bottlenecks in the field of agricultural products, just as you do in the field of industrial products, and it may be necessary to carry out such portions of the agricultural program as have been used in the past for maintaining a floor under certain agricultural prices.

That does not necessarily mean, however, that there are not other agricultural prices that would go through the ceiling without a price control.

The CHAIRMAN. My question relates to the benefits secured by existing laws, legislation passed on its merits without reference to this existing emergency and its problems.

Mr. ECCLES. I am not sufficiently familiar with the details of all of the agricultural legislation that has been passed to be able, Mr. Chairman, to answer that question.

The CHAIRMAN. My question relates also to wages. You are familiar, I assume, with the various acts of Congress that give benefits and protection to labor.

Mr. ECCLES. I have felt very strongly, during the period of deflation and unemployment, that there had to be a much wider and better distribution of the national income, as well as a great increase in the national income, and that the purchasing power of labor and agriculture, if we were going to ever get prosperity, had to be augmented. In order to accomplish that, I was in full sympathy with the passing of certain agricultural and labor legislation, giving to them benefits which I felt, from a purely economic point of view rather than a political point of view, were thoroughly necessary and desirable.

The situation, of course, has gone from one of depression and deflation to one on the other side, and it seems to me that we may have to alter to some extent our pattern, both affecting agriculture and labor, in their own interests as well as in the interest of everyone else, to prevent inflation, just as it was necessary to change the pattern to deal with the deflationary problem.

I have wondered whether or not it would not be greatly in the interest of labor, speaking of it in the broadest sense, during a period of emergency such as we are in, to have a suspension of the 40-hour week. Whether we have reached that point yet, I would not be prepared to say, but it does seem that, with a shortage of certain categories, with inflationary developments, that we might be justified, purely as a temporary matter, in making the workweek 48 hours instead of 40.

I do think that there is a justification, under other conditions, for a 40-hour week. It would tend to give them possible greater employment. It would tend to help the solution of the unemployment problem.

With reference to the wage picture, it is not possible, by merely tying wages and salaries to a cost-of-living index, to solve that problem. To do that is assuming that the present standard of living, as enjoyed by most people today, can be maintained.

Now, as prices go up, if we then follow up those prices with increased wages and salaries and increased agricultural income, that of course increases purchasing power, which really is not the problem.

But merely increasing purchasing power for a diminishing supply of goods only accentuates greater the inflation problem. Sooner or later the public, it seems to me, must be made to understand that what will be available for civilian use will be that portion of our total production left after the defense requirements are taken care of: and if we increase the defense production to take care of our Allies, as it appears will be necessary, certainly the civilian supply in many categories is going to diminish; and to meet the problem by increasing wages and salaries, corporate earnings, and farm income, only means an increased buying power for a diminishing supply of goods.

So that labor, agriculture, and business should all be made to understand that such a program would defeat not only their own interests but would bring about an inevitable inflation. There would be very few, if any, gains or ultimate benefits out of such a result.

So that to feel that wages, salaries, and other income—and I do not care what the income is—should not be further increased, generally speaking, at this time to meet increased costs, does not mean that I am speaking against the interests of labor. I feel that I am advocating what is in the interest of labor, in the interest of agriculture, and in the interest of business.

The great majority of the people in this country have some insurance. The great majority have some savings, either in mutual savings banks, building and loan companies, or in the commercial banks. There are a great many fiduciary institutions, churches, educational institutions, all of which depend pretty largely upon a fixed income.

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Inflation would be ruinous to all such institutions, and they, in turn, reflect the interests of the people as a whole.

I have made a statement which I suppose sounds rather academic but I hope, Mr. Chairman, that in this manner I have answered your question with reference to my attitude about the agricultural and the labor problems.

The CHAIRMAN. Well, do I understand from your general statement that you favor legislation conferring upon some central authority elastic discretionary power to regulate or to stabilize prices, with a view to preventing inflation, but you do not favor a plan that would arbitrarily fix prices on all commodities as of a certain date?

Mr. ECCLES. That is correct, and it is for this reason that I prefer using to the fullest extent, as I mentioned in my opening statement, functional controls, supplementing those as fully as may be necessary by selective price controls.

Now, the reason for price controls in the first instance is shortages in certain categories, and it is because of an inability to meet those shortages readily, immediately, by increased production. Due to those shortages, in order to secure goods for defense, priorities and allocations are essential. Wherever, therefore, you have priorities and allocations, a corollary, price control, becomes necessary.

Now, as we fail to dampen or diminish general purchasing power, and the shortages continue to exist or to extend, so that the supply is inadequate to meet the increased purchasing power, to that extent we will find it necessary to issue priorities and to allocate materials not for defense purposes, but for civilian supply, and price control will likewise have to expand, will have to follow, because it is a necessary corollary to priorities and allocations.

Now, if we fail to have an adequate tax program, if we fail to induce enough of the funds that are put into circulation to get back into Government, through the sale of bonds and through the other means, such as increasing social security, taxes, and various types of special savings schemes which have been advocated, if we fail to bring back the funds in those various manners, we might well find that the shortage spreads to a broad enough category so that price control would have to be extended all the way down the line and we would finally have to issue ration cards.

Until we get to the point where it appears to be necessary to allocate all production of materials between civilian and defense requirements—until we reach that point, it does not seem to me that price control covering the entire category is essential.

I dread the thought, even under the most acute war condition, of trying to organize an economy as divorced and as extensive as this economy is, to administer a program of price control and allocation all the way down the line from the producer of raw materials to the ultimate consumer, in every category from the manufacturer and the jobber to the retailer. I cannot conceive of an organization that could perform effectively and successfully any such task, even in the German system, which is small compared with ours and which operates in connection with people who have been used to discipline. And even there, the most drastic measures have to be used—the power of a firing squad.

In England, as small as that country is, they have had the utmost difficulty in trying to carry out a rationing system.

With purchasing power in the hands of the public in excess of the supply of goods, and with a system of rationing and a system of price control which says that you can have only so much clothing, and you can have only such-and-such food and you can get it at such a set price, after that is accomplished, with the money left in the hands of the general public, you can well understand what the job would be to prevent bootlegging of all kinds.

So price control is essential, but the most vigorous functional controls should be put into effect so as to limit the field where price control is necessary because of the difficulty of administration of allocation and price control.

The CHAIRMAN. This would be true, would it not, as to any commodity or article regulated under a selective system; there may be a change in conditions, such as an increase in production as would remove any necessity for control, but if you had an arbitrary legislative enactment fixing the price there would be no way to meet the changed conditions with respect to such commodity or article; is that not true?

Mr. ECCLES. There is no question that the status of production is not static in any field, and neither is demand static. I have felt that there has been in certain categories an undue amount of apprehension, that there has been a great deal of forward buying, not only on the part of business interests but on the part of consumers, which may not be repeated. There has been a good deal of speculation in commodities against which most drastic measures should be used to prevent its continuance. Undue inventories have been accumulated on the mart of many manufacturers and those should be redistributed to those institutions that are unable to operate because of shortages. There have been cases of individuals, as well as merchants, who have piled up supplies of certain materials, maybe entirely out of their own field of operation, for pure profit and speculative reasons. That sort of thing should be prevented, and action of that sort may tend to relieve the situation in certain fields where the shortages may not be so great as is apparent.

The CHAIRMAN. Let me ask you what suggestion you would make as to specific legislation authorizing control of wages.

Mr. ECCLES. Well, I do not feel, Mr. Chairman, that I am a sufficient authority on that subject. It is quite out of the practical problem, which is, of course, a big one. I do not believe that I feel adequate to suggest the type of legislation that might be practicable or desirable to deal with that subject. I am speaking of the problem in its economic relationship to this problem of controlling inflation, of which price control is a very important factor. I merely undertook here to show that you cannot control price with price control if wages, salaries, and other incomes are permitted to continue to expand.

The CHAIRMAN. I think everybody will agree that that statement is correct; if we contemplate complete 100 percent control and there is among us some who feel deeply that there should be at least sufficient breadth of any control applied to insure impartiality among classes in the operation of any plan we might adopt. Of course, this thing of agriculture and wages is very important in anything we undertake to do, and a great many express the view that agriculture should not be regulated unless wages are to be regulated. But so far as the committee goes, it is without any specific suggestion or plan by which we might write into the bill effective provision for the control of wages. I am wondering if you could help us at that point.

Mr. Eccles. I realize that what you people want is practical suggestions and that academic discussions you have had a lot of.

The Chairman. One of the ablest and most interesting, and I might say fascinating statements I ever heard before this committee was made by a gentleman who said just what you do, that there should be control of wages, but when we get down to methods and details the statement was made that you could not deny labor the right to strike when it wants to do it. That being the case, I don't see how we are to avoid all the difficulties that confront us in any effort to regulate wages. Of course, we know wages constitute an important part of the costs and the price of things. We find ourselves in some difficulty at that point.

Mr. Eccles. Wages and salaries, as I understand it, represent at least two-thirds of the national income. I don't know what part agriculture represents, but if we add agriculture to that we do not leave very much to control if we do not control either of those two.

I recognize that as long as freedom is left with agriculture, in the field of its production, what it will produce, whether or not it will fill its production, and at what price, as long as business is left with the freedom it has, certainly it is not very consistent to say that labor cannot strike, that labor has got to work whether it wants to or not. You cannot do that. It has got to have freedom.

The Chairman. You cannot do it, and nobody wants to do it. Then, ultimately, we may reach the point where you will require one man to work for another so that the other man may make money, and you can't do that.

Mr. Eccles. It may be, to be ultimately successful in the defense effort, we will be forced to resort to the very system we would like to see defeated. I sometimes fear that that may be possible, when we see the difficulty of getting at these problems in any voluntary manner, that the democratic processes under the conditions in which we live do not seem to work very effectively or efficiently.

The Chairman. I am afraid we are not disturbed so much by the continent's principles as what we should do. The question is what can be done.

Mr. Eccles. I am just talking off the cuff here, and I wouldn't have volunteered this, but you raised the question. It does seem to me that in the British situation they have not had the problem of strikes and wage increases and so forth that we have had by any manner of means, and it is not because their labor is paid very much better than labor here is paid. It is not paid nearly so well. Our labor organizations in this country are greatly decentralized, and in times of this sort that proves to be somewhat of a disadvantage, in that demands are made that the labor statesmen, labor leaders of our country may not be in sympathy with, but you know all over the country, in isolated cases, small as well as large strikes, at least threatened strikes occur and demands are made. The demands in many instances may be unreasonable, they may be coercive in nature. I am wondering if it is not possible in the interest of labor to have more centralization of the labor problem brought about, that the labor problem be dealt with through a central labor organization, that an effort be made by such an organization—I am speaking just during the emergency period—to try to work out with other agencies of government who have the responsibility for dealing with this inflation problem a schedule of wages, a schedule of what we might term in each area the prevailing wage, and that that prevailing wage would be the base until there was some justification for getting away from it. I think there would be created thereby a framework or a pattern of wages into which the entire wage structure might fall. In other words, today there is no yardstick, there is no pattern. The situation is more or less chaotic. Each group of workers, no matter where they may be, no matter what conditions are, how favorable are conditions, are in a position to move out independently.

Normally that is all right, but we have had to centralize a lot of things in order to get control—and I am not talking about centralization through a fixation of wages by possible legislative action; I think that might be very difficult—I am thinking of some sort of mechanism that might centralize, during the emergency, this problem, with the idea of working out a pattern of wages whereby this disorganized labor-and-wage problem might have some yardstick or some guide whereby the general public sentiment would have an opportunity to be expressed, because, after all, in all of this, all of this public sentiment is a very, very important and determining factor.

Mr. FORD. Hasn't that been done, Governor Eccles, through the medium of what are known as area agreements?

Mr. ECCLES. It may be. As I said in the beginning, I am not an authority on this subject, and I would not have volunteered it except the chairman pressed me with reference to this particular subject.

Mr. FORD. Your suggestion is exactly in line with what they are trying to do right now.

Mr. GORE. Who is trying to do it?

Mr. FORD. The airplane people, and there is one among the shipbuilding people, where there is an area base from which they will not depart.

Mr. ECCLES. Doesn't that only apply to the shipbuilding?

The CHAIRMAN. All these various things are fixed by the Government are in operation now, but there is a demand with which everybody is familiar that legislative action be had to terminate strikes with respect to defense production, and there is no machinery by which to do it.

I hope you will understand my questions of you are not meant to be pressed, particularly; it was for the purpose of getting your views, because we all know how smart you are, and I was wondering if you could not make some contribution that would be valuable to us in meeting that problem, because so far we have had the same suggestions, that we should in this legislation deal with labor, but nobody has told us exactly how to do it, and that is what we need to know.

Mr. ECCLES. Well, the British, of course, are the best practical example of meeting the labor problem in the war emergency. It would seem to me that what legislation dealing with this labor problem exists there we might pattern after with some merit. I don't know. But certainly they have had a very satisfactory labor condition prevailing over there, not only during this war emergency but since the general strike in 1926.

The CHAIRMAN. What legislative machinery have they for dealing with these problems?

Mr. ECCLES. As I say, Mr. Chairman, I am not familiar with what the machinery is sufficiently. I know in a general way, but I am not sufficiently familiar that I feel I ought to discuss it.

The CHAIRMAN. Isn't this the situation: That they simply have a voluntary agreement, and that is all they are relying on?

Mr. ECCLES. No; they have what is known as a labor relations act.

The CHAIRMAN. We have that, haven't we?

Mr. ECCLES. Not the labor relations act. Anyway, it was a labor action passed in 1926, I think, that has proven to be the basis upon which they have operated, and they since that time have had practically no strikes. They have had a good deal of collective bargaining and negotiations, but since that act was passed they have had very few strikes. Whether the same type of mechanism would give the same satisfactory results here, I do not know. Of course, they have recognized much more fully than we have, and I think that might have been helpful, the principle of trade-union organization, and the country as a whole is organized. There has been of course a great resistance in this country to accepting organized labor in many industries, and therefore the labor organizations possibly have less responsibility than they would feel if labor was more fully and completely organized than it is. In Britain, as I say, it is much more completely organized and that has placed, of course, not only great power in the hands of labor, but likewise very great responsibility, and that may be a factor in the picture.

The CHAIRMAN. I would suggest you outline to the committee the very method that you would recommend by which to prevent inflation.

Mr. ECCLES. I will be glad to do that, Mr. Chairman. I have within the last year made several rather comprehensive statements on this subject, and the first one was as early as last November, before the National Conference Board in New York. The second statement I made was before the United States Chamber of Commerce, which was not quite so comprehensive, but did deal more specifically with the problem of taxation and methods of financing defense, and then more recently a statement for Fortune Magazine. Now about all I can do is to try to briefly reiterate the methods, what might be termed the functional methods. I think possibly I may have said enough on my conception of the place of price control and priorities and allocation in the picture. I certainly recognize those and have recognized them since the first statement I referred to last November, as being basic, being fundamental and necessary, and the extent to which we will have to use them will depend upon the extent to which other functional powers may be used.

Now, taxation is the most important single functional means of getting at the problem. Certainly, with the Government attempting to put into the economy, largely for defense purposes, 20 percent, we will say, of our national income at the present time, and with the idea that it may reach 30 or 40 percent—as I understand it, 60 percent of the German national income is devoted to war and defense purposes, and 40 percent for civilian use. The British is divided about 50–50. Now, if we have the shortages we have when we are utilizing but 20 percent of the national income, we can well understand what the development is likely to be if we double that, and that should reach 40 percent.

Now, in pumping those funds out, naturally the national income rises, first, primarily due to increased employment and increased production, and then it would continue to rise in dollars through inflation, even if we reached the limit of our productive capacity. With that situation, it is perfectly obvious that these funds should be garnered back into the Government, and theoretically, politically possibly—practically, we cannot balance the Budget, but theoretically, when you have reached the peak of your productive capacity through the utilization of your manpower and your productive facilities, you cannot create any more wealth to tax, and there is no reason then—I say theoretically that is the time to balance the Budget; politically the tax would have to be so drastic that it will be quite impossible to do so—however, much greater effort should be made than has been made in the field of taxation. I can go into that field, but that is rather an extensive field. I could discuss the types of taxes——

The CHAIRMAN. While you are on that, let me ask you, just how far do you think the Government should go in the recapturing of excess profits, or profits?

Mr. ECCLES. Well, it ought to go a long way. Certainly the taxation should start from the top and come down, and not the bottom and go up.

I have expressed my views with reference to this corporate tax question before the Ways and Means Committee of the House. I also have expressed them elsewhere.

Mr. KEAN. May I interrupt there? Was that in the hearing on the bill just passed?

Mr. ECCLES. Yes, sir.

Mr. KEAN. In the Ways and Means Committee?

Mr. ECCLES. That is right.

To be more specific, I have greatly favored what is known as a floor and a ceiling plan, based upon a base period of earnings. I suggested the 10-percent ceiling plan and a 5-percent floor plan. In other words, whatever base period is used, if a corporation made less on its invested capital than a 5-percent return—and I realize that there is a queston of definition of invested capital which is important—that it would not then be permitted to make more than 5 percent before it was subjected to the excess-profits tax. If a corporation had been making more than 10 percent during the base period it would not be permitted to make more than 10 before it would be subject to the excess-profits tax.

The excess-profits tax should be greatly increased over what had prevailed. I feel that possibly with the $5,000 exemption, maybe less than that, but certainly no more, that the excess-profits rate of taxation, instead of being what it had been, I think 20 percent, should possibly start out at 40 percent, and maybe as high as 50 percent, and when the earnings had reached, say 12 percent, anything above that, or 15, that then the tax should be at least 75 percent.

I never advocated a 100-percent excess-profits tax. I am very much in favor of the theory that everyone should make real sacrifices during the emergency. I am well aware of what the draftees are called upo to do, and I feel that the idea of profit being made out of defense is no popular. I also feel that the labor problem is greatly accentuated an made more difficult when you want to hold down wages and yo permit great profits. That is not very practical or feasible.

And yet, as a practical matter, until the Government is prepare to take over all industry and take over all management in the Gov ernment service, the same as we took over the draftees, there must b left a sufficient incentive to get results that are necessary by way o efficiency and increased production. I therefore would like to see th corporate incomes held down to just as low a point as practicabl without interfering adversely with the efficiency of production. W have the last war as a base, we have the British, we have the Canadians The Government has not yet taken over industry in any of thos countries, and in those countries they do not have 100-percent ta above a certain earning base. They do, however, I think, particularl in Britain, have a very much more drastic corporate tax than w have, just as they have a much more drastic individual tax, and I think that we have got to move just as fast as we possibly can in th field of increasing corporate taxes as well as individual taxes an excise taxes, particularly on those items that there is a shortage of The excise taxes that were placed on those articles is entirely inade- quate, and I feel the tax should be very much heavier on those par- ticular items.

In the last war we had an excess-profits tax of 80 percent, and I think the next rate was 60. I am in favor of moving in the field o both individual, corporate, and excess taxes, just as far as it is possible to go, politically, just as far as it can be done without th reaction being more—well, without the reaction to the taxes causing more difficulty in other directions than the tax itself.

You asked me to say something on the other field.

Mr. CRAWFORD. Mr. Chairman, right there, may I interrupt?

The CHAIRMAN. Yes.

Mr. CRAWFORD. Mr. Eccles, do you mean to say Britain did not have a 100-percent excess-profits tax?

Mr. ECCLES. They did put one in, but as I understand it they took it out. The maximum is 80 percent now, and the 20 percent must be taken in deferred payments. However, they have the privilege of in- vesting that in Government securities. The Government recaptures it——

Mr. CRAWFORD. That is, the Government recaptures 100 percent.

Mr. ECCLES. That is right; but 20 percent of it is in bonds. That is quite a little bit different than 100-percent tax.

Mr. CRAWFORD. Yes.

Mr. ECCLES. The most effective way, I think, of recapturing some of the purchasing power would be to increase very substantially our social security payments, and likewise the benefits.

Little benefits will have to be paid, especially in the unemployment field, during this period. There may be some. However, this is the time when we cannot build up too rapidly the reserve in the social security account, just as in the depression period we should not have undertaken to build up the reserve at all. We were collecting taxes that diminished consumer buying power when we needed to increase consumer buying power. The reverse is true today. We should levy just as heavily as possible. You might call that an enforced form of saving. It is using an instrument that is already set up. The coverage of social security should be very greatly broadened, the coverage is not adequate. It should be greatly broadened, in my opinion, at the same time that the rates are increased.

I would like to see collected into that fund an amount in excess of what is paid out of several billion dollars a year. We have been collecting, as I understand it, around $1,000,000,000 a year in excess. I see no reason why under present conditions we might not collect into that as much as at least $3,000,000,000 or maybe even more as the national income increases. That would be building up a backlog of purchasing power to help cushion the post-defense period, if unemployment should develop. But the unemployment benefits should be increased in both the period of time that the unemployed should receive the benefits, as well as the amount that they should receive. It may be at that period that the social-security fund would collect less than it paid out. As a matter of fact, it should, under those conditions, collect substantially less than it paid out. The rates that may be greatly increased now could be greatly diminished, or maybe even temporarily suspended and use the reserve at that time, so that the fund then would be used as a great cushion at this period against inflation and could be used as a great cushion against deflation. It could be used, it seems to me, more effectively than any other functional interest of control.

The unemployment end it seems to me is largely in the hands of the States, the unemployment insurance, and I think it may be necessary and desirable to make that part of the national control more effective than it is today.

Now, there is a good deal of talk about pay-roll deductions to be made in the form of savings bonds. In other words, a deferred pay. There may be in connection with working out the wage and labor problem that wages and salaries beyond some point, beyond a subsistence level, and we must have, I think, a minimum subsistence level that is not subject to taxation, but it may be that wages and salaries beyond some point may be drawn into or can be paid into some form of Government bond, defense savings bonds. The British have used what is spoken of as the deferred savings plan, a pay-roll deduction. It does not amount, I think, in the aggregate to very much money. If you are going to choose between the social security and enforced savings plan or the deferred payment plan, which I prefer to call it, I would prefer the social security, first, because the benefits go out to those unemployed and those who reach the retirement age, rather than to those who have paid into the fund. In the deferred savings plan the disbursement of that saving is left up entirely to the individual who did the saving, and therefore that fund of saving would not be used as fully, or possibly used for as good a purpose for the economy as a whole as would be the social security. It may be desirable to do both, not only use the social-security method of increasing the savings, but it may likewise be desirable, as time goes on, to work out some form of deferred wage, a saving which would be expressed in Government securities. I think that should come as a secondary measure.

Mr. DEWEY. Mr. Eccles, just before you leave that point, may I ask this one question? Both the deferred savings bonds, or an increase of social security, which contemplates the paying out of the benefits after the emergency, create a demand liability, and there might be a falling off in values of Government securities at that time, and I was wondering if you would care to say a word as to the form of financing demand liability, which would be very large, at a time when Government securities might be at a discount.

Mr. ECCLES. Of course, the pattern of savings securities has already been established in the brief series of savings bonds. They are, in effect, a demand security, with a penalty, an interest penalty, if they are cashed in before they mature. You possibly are all familiar with those three forms, which seem to me to make the pattern. The investor is protected against loss, likewise he has no opportunity to get a premium. They are on tap. They sell at par, and they will, of course, not sell at less than par as long as the Government stands ready to redeem them at par, and it must stand ready to redeem them at par.

Any further financing it seems that might be done, unless it happens to be open-market financing, which I should think should be greatly limited and discontinued as soon as possible—the British have practically discontinued, I understand, open-market financing shortly after the war started, and that is a general development in war economy, that open-market financing is not well adapted, in my opinion, to meeting a continuing war emergency, for the primary reason that the securities are largely underwritten by the banks; for the second reason that they must be offered at some underwriting figure in order to get them oversubscribed. The situation, then, is a secondary market offering, a certain amount of speculation in Government securities. In fact, a very large amount.

Now, in order to accomplish that kind of financing the banks, as I say, are the principal underwriters, and the banks under those conditions must have a large supply of excess funds that would assure the underwriting, so that to the extent that we can tap existing funds in the monetary field it is desirable and would avoid a further expansion of bank deposits through an increase in Government bonds by the banking system.

I have felt for some time that the existing supply of deposits and currency could finance a very much larger amount of Government requirements than they are financing. The velocity is still very light, and the funds that are idle in great abundance should be drawn in by a type of security that would appeal to investors who have not yet been appealed to. I don't know whether that answers your question or not.

Mr. DEWEY. It does. Thank you very much. But there is one point. The point I was raising was that these securities and the social-security payments would have to be paid over to the holders of the security or the beneficiaries of the social security probably at a time when it might be difficult for the Government to do financing, probably, with reference to the commercial banks. Then you would suggest holding them in reserve until such a time as you might have to get them to take Government securities rather than market operations, because the people's willingness to take Government securities is more or less negligible?

Mr. Eccles. Well, what has been known in the past as our natural financial system no longer exists. Our financial mechanism here and in every country in the world is an artificial system. It has been much more artificial in times past than has been generally accepted and recognized, but it is entirely artificial at the present time, and is subject in this country—must be subject in this country, as it is in England and every other country—to complete public control.

During the period when the international gold standard was in operation we talked of our natural markets and to some extent the financial markets were natural, certainly to a much greater extent than today, and when gold was low the basis for extending credit was diminished and therefore money became tight. When gold expanded and the supply of money expanded, money became easy as the result. Since that time we have recognized that financing can be done, as in Russia and in Germany, without gold, that the money system in itself does not depend upon the gold standard, and that the Government can exercise control over the reserves of banks, and hence over the interest rate structure if it chooses to do so, so that the problem of getting an adequate supply of money to finance the defense is no problem. Money itself creates no problem in this picture. Likewise in a deflationary period there would be no problem of finance. It is a question of using the financial mechanism in such a manner as to avoid, so far as we can, through the use of the financial mechanism the inflationary developments, and to use it in a deflationary period in such a manner as to contribute to whatever extent the financial mechanism can contribute to prevent deflation.

I am not one of those people who believe that everything can be done through the control of the financial system. I think it is a factor, but I do not think it is the major factor in either controlling inflation or controlling deflation.

Mr. Dewey. It strikes me it would add very considerably to the problem of controlling inflation. If I am correct, records in these hearings have shown that inflationary tendencies take place more vigorously immediately following the war than they did during the few months prior to the war, and if you had to throw in on top of that tendency a lot of almost inflationary types of financing, it might add to the difficulties of the price administrator in controlling prices.

Mr. Eccles. The fund that would be used for defense purposes would under conditions of a post-defense period, when the defense is over with, be diverted to whatever extent was necessary for nondefense purposes. Your deposit structure will be large. It is large now, but it may be larger when the defense period is over with, so that the use of Government credit to the extent it has been for the financing of defense would no longer be necessary, and to the extent that the holders of savings bonds converted those bonds to cash it would give employment, it would keep the structure going, and it would make unnecessary the financing by the Goverment of a post-defense slump. You then have either the individually held savings bonds, or the bonds bought with the social security, which will either then be used, and if they are used, the Government would then not have to undertake a lot of deficit financing to the extent it otherwise would to finance a slump. To the extent those bonds are continued to be held, the Government would have to finance the slump, so that it is a case here of how we will take care of the bonds we will sell now that represent a deficit.

You see those bonds now that are being sold create the Government deficit. If those bonds were used, and there was a market, outside, the banks or elsewhere, then the Government would have no deficit—I mean the deficit would be diminished, might disappear, to the extent they were used, and to the extent the market was not able to take those bonds up, the Government which has agreed to take them on demand, especially this certain series of bonds, the Government would have to do enough financing in the market to be able to redeem the various bonds which they have put out at this time, so that it would not be a case of increasing the deficit. It would merely be a case of substituting a market issue at that time to get funds with which to retire the savings bonds that are put out at this time.

The CHAIRMAN. Mr. Eccles, it is necessary that I have to leave on account of urgent business in the House. I hope you will understand.

Mr. CRAWFORD. Would it be agreeable for Governor Eccles to insert in the record following his formal statement these three other statements to which he referred?

Mr. ECCLES. Which statements do you refer to?

Mr. CRAWFORD. The Fortune article, the one before the Industrial Conference Board——

Mr. ECCLES. And the one before the chamber of commerce?

Mr. CRAWFORD. Yes. I think those three statements have so much to do with this subject that, if it is agreeable to the committee, I would like to have them follow your formal statement this morning.

Mr. WILLIAMS. Have you those statements available?

Mr. ECCLES. I have not them with me, but I will be very glad to bring them this afternoon, and if the committee desires, have them inserted in the record.

Mr. WILLIAMS. They may be inserted.

Mr. ECCLES. I think, Mr. Williams, that in answering Chairman Steagall's questions, I believe in rather a rambling manner, I have pretty well covered these various functional powers, and I don't believe I have any more to say on the general subject.

Mr. WILLIAMS. Have you covered in a general way the Federal Reserve Bank System's operations or controls over credit and currency? I assume that is part of the fundamental functional control.

Mr. ECCLES. I could say more on that subject. I think, however, in answering Mr. Dewey here that I have pointed out the importance of the excess reserves in the picture. Maybe I could say more on that subject.

I would like first to say that this over-all credit control occupies a much less important picture in inflation control, I think, than has been generally recognized. Certain selective credit controls should be used where practical. I do not mean that they should be used as a substitute for an over-all credit control. I do mean that they should be used as supplementary to the over-all credit control, supplementary to the entire problem of dealing with inflation. I have in mind, for instance, installment credit. There may be other fields of credit control that could be used in a useful manner, such as control of credit for housing, such as control of credit for other expansion of unnecessary capital investment.

Speaking on the over-all credit control, my thought is this, that it is a passive instrument of control. In a period of deflation the absence of excess reserves on the part of the banking system creates high interest rates and forces a contraction of credit, which accentuates deflation. It is desirable, in fact it is absolutely necessary, in a deflationary period, as we found in 1933, to create what we term an easy money situation. That was done. The usual central banking system mechanism, is to purchase in the open market securities, which gives funds to the banks which are first used to pay off what the banks owe the Reserve System, and there is a pressure of idle money on the market. That creates a climate which is favorable to expansion and tends to stop the deflationary trend brought about by the pressure in the credit system.

However, merely idle funds and easy money do not of and in themselves create business activity or prosperity. We found that out and every other country has found it out. It only creates a condition favorable to the expansion of activity, other things being done.

Now, on the other side of the picture, the reverse, in my opinion is true, that an excessively easy money situation creates a climate favorable for the further expansion of credit, loans and investments of all kinds. As a matter of fact, the lower the interest rate drops, the greater the pressure to invest funds in order to offset the loss of income through a reduced interest rate, and it is somewhat like a dog chasing its tail. There is a point, of course, when likely a bottom would be reached in the picture, and then any financing that might be done at that bottom point would show a loss to the investor, unless that bottom point was maintained indefinitely, so that it has seemed to me, as I have expressed my views in these articles referred to, that the over-all monetary controls are the social part of the functional credit controls. However, in looking upon the great interest that the Treasury naturally and necessarily has in a situation of this sort, with the large amount of financing that they have to do, they are possibly as much or more concerned about this problem than the banking authorities. It is not possible in this country, and it is not possible in any other country for the banking authorities under emergency conditions to act with independence. It has not been possible in Britain or Canada or any other country, and it is not either possible or desirable in my opinion in this country. I feel that whatever may be done in the over-all credit control field must be done always with an eye to the Treasury's problem of its financing, and therefore must be done in full and complete cooperation with the Treasury, and in the public interest.

That does not necessarily mean that I may not have certain views as to what should be done and the way it should be done. It does not mean that my views with reference to the place of over-all credit control may not conform to the views of the others, but I am sure you will all agree that in times of emergency that the coordination and cooperation between banking authorities with the Treasury is an absolute essential in the public interest, and to that end the Secretary of the Treasury and I issued a statement a few days ago which was an effort to point out the close interest—I mean the common interest—that we had in the problem and the need of the closest kind of cooperation, the futility of either of us undertaking to act separately and independently. So far as the Board is concerned, or the Treasury is concerned, any recommendation that may be made with reference to this whole field will be done jointly, after further consultation. That is speaking for the future. That does not mean that my views as have been expressed and are in the record have necessarily changed.

Mr. WILLIAMS. The committee will stand in recess until 2:30.

(Thereupon at 12:20 p. m., the committee took a recess until 2:30 p. m. of the same day.)

AFTER RECESS

The hearing was resumed at 2:45 p. m., at the expiration of the recess.

The following members were present: Messrs. Steagall, Williams, Spence, Ford, Brown, Patman, Gore, Mills, Monroney, Lynch, Boggs, Hull, Crawford, Kean, Miss Sumner, Messrs. Smith, Kunkel, Rolph, and Dewey.

The CHAIRMAN. The Committee will come to order.

Mr. FORD. May I make one statement that will take about 5 minutes?

The CHAIRMAN. Yes.

Mr. FORD. Mr. Eccles, we have heard by and large that there has been a great deal of demand here for a ceiling on wages. There has been a great deal of talk about the amount of detriment to the defense program that has been caused by labor strikes. Some of that is true and some of that is exaggerated. But not one of the people or not one of the newspapers who have been playing up to strikes has said a single word about a little bill that passed Congress back in June, giving the President the right to requisition a lot of second-hand precision machinery that has held up several plants all over the country.

Of course, the bill won't help now. It won't give the President the right to take these. He cannot do that until we finally pass the bill. But I don't believe that a single newspaper or a single group that has been thinking about this labor situation has said one word about that. That is all I have to say. I just wanted to get that into the record.

The CHAIRMAN. Mr. Williams is recognized.

Mr. WILLIAMS. As I understood your testimony this morning, Mr. Eccles, you covered fully what I call the over-all controls—taxes, Treasury fiscal policies, and the Federal reserve montetary and credit policies. So far as I understand it, the Federal Reserve System has recently put into operation two measures designed to affect the credit policy of the country. One was restricting installment credit buying and the other was raising the reserve requirements. Has the system taken any other measure on those lines in recent months, Mr. Eccles, to affect the credit policy of the country?

Mr. ECCLES. No. There has been no other action by the Federal Reserve System that would in any way affect the credit policies of the banks or of the credit institutions.

Mr. WILLIAMS. To what extent has this installment credit policy been changed?

Mr. ECCLES. There has been no amendment, I believe. As I said, I have been away on vacation for a little while. But so far as I know, there has been no change or no amendment, to the original regulations. There have been a good number of rulings, by which I mean interpretations of the regulations, but no amendment.

Mr. WILLIAMS. To what extent did the rulings or the regulations that were already issued affect that policy? How did it change the prior existing installment-buying policy.

Mr. ECCLES. I think the regulation had very little effect on installment buying. We recognized that the regulation was extremely liberal; and we felt that until the Federal Reserve Board and staff and the Reserve banks had got organized and had some experience in the new field, which this is, that approach was the desirable one.

The question of controlling installment credit is a very complex and very difficult job. If it only involved banks, that would be comparatively easy. But it involves tens of thousands of credit institutions other than banks. For that reason the Board felt it desirable, and this was done in consultation with Mr. Henderson's staff, who is greatly interested in this question of consumer credit, for the reason that it was felt that control of the consumer credit was a very important supplemental power to the principal control.

Mr. WILLIAMS. Has any Government agency ever undertaken to regulate the installment-buying policy before?

Mr. ECCLES. Not that I know of. I think this is the first attempt.

Mr. WILLIAMS. Is this a new field entirely?

Mr. ECCLES. It is a new field.

Mr. WILLIAMS. Do you think it should be extended to real-estate installment buying?

The CHAIRMAN. Just a minute, before you answer that question.

I do not remember just what the regulation covered, but I do have a definite recollection that there was at one time more or less discussion of an effort to regulate installment buying under the guidance of the Federal Reserve Board. I do not mean since you were on the Board. I mean back in the first World War. Do you have a recollection about that?

Mr. ECCLES. No; I do not have. Maybe Dr. Goldenweiser would know.

The CHAIRMAN. I don't know that there was any action specifically limited to installment buying. But installment buying was considered along with the general matters that went into the policy of the Board.

Is that right, Dr. Goldenweiser?

Dr. GOLDENWEISER. Yes, sir.

The CHAIRMAN. At that time there was a restriction of credit, was there not?

Dr. GOLDENWEISER. In 1920, do you mean, Mr. Chairman?

The CHAIRMAN. Yes.

Dr. GOLDENWEISER. Yes.

The CHAIRMAN. That was based in part on a desire to curb installment buying. I remember the discussion at that time. It was directed, for instance, at automobiles.

All right. Proceed. Maybe I should not have interrupted, but I wanted to call attention to that.

Mr. WILLIAMS. I just had asked you a question as to whether or not you thought this policy of controlling installment credit should be extended to the purchase of real estate.

Mr. Eccles. It may be necessary and desirable at some point to do that. The construction of homes is being and is likely to be greatly curtailed through the functional method. As I understand it, in nondefense areas priorities will be given for the purpose of furnishing materials for the construction of homes the cost of which would not exceed, I think it is, $6,000. So that in effect if building materials can only be delivered, can only be sold, on the basis of a priority authorization, then, of course, that is a direct method rather than a functional method of dealing with the problem.

It may have been true that through the use of credit control housing may have been restricted on a functional basis to a desired result. That is, if there is in the installment credit field, for instance, a credit for housing restricted by increasing the down payment to any amount necessary to restrict it, or by reducing the period in which the home should be paid for, that in itself could very, very greatly, of course, restrict home construction. Likewise, if credit of any kind could absorb, we will say, the purchase of homes the cost of which exceeds some amount, all that would have acted as a general function of restriction.

But as it is it would appear that practically all home construction may be stopped in other than defense areas if materials can be secured only on a basis of getting priorities, and those priorities are being issued only in defense areas.

That, of course, creates this kind of problem: It accentuates the deflationary problem in the nondefense areas, and it increases the inflationary conditions in the defense areas. I mean, that is the practical effect of it. I am not saying that there is not some other way of doing it. I don't know now enough about it to be critical.

Mr. Williams. The Board has raised the requirements to the legal limit, the limit to which the Board is permitted to raise them under the law. Do you think it is necessary to extend that further act of Congress? I mean by that, of course, increasing the amount to which you can raise it in addition to what you have already done.

Mr. Eccles. I am on record on this whole subject rather completely, and I have not changed my views.

To the extent that anyone feels that over-all credit control is important in dealing with this subject, just to that extent one would have to favor giving somebody the power so as to be able to exercise that over-all credit control. That power today does not exist.

The Chairman. Let me ask you if you will be kind enough to state the condition that the law is in now, and how far the Board should go or be authorized to go by any subsequent legislation.

Mr. Eccles. The law authorizes the reserve system, the Board, to double the statutory power. The statutory requirement is 7 percent for what are known as country banks, 10 percent for what are known as reserve city banks, and 14 percent for what are known as central reserve city banks. The power is to double those requirements.

The Board has acted to increase the reserve requirements of member banks to the full amount now permitted by law.

I might get into a rather lengthy discussion, Mr. Chairman, if I should undertake to go into a statement and the reasons for it of what further legislation in this field might be undertaken. I would prefer to avoid a discussion in detail of that sort, because there is no such bill at this time before us. If there was I, of course, would be very glad to discuss any such bill.

I would like to answer your question without going into too much detail, merely by saying that I would repeat what I have said a good many times before, that I think that powers should be given either to the Reserve Board or someone else to exercise an over-all control.

Now, as to the form that those powers take, there can be differences of opinion, and as to the methods used. There have been several plans that have been discussed and suggested by different people who have made a study of the situation. I, of course, have my views and reasons for them.

This much is certain: That it would be folly to give any organization the power to further deal with the over-all credit situation unless that power extended to all banks of deposit. Otherwise the Federal Reserve System, as it must exercise that power, may well be destroyed through withdrawal of banks from membership and through failure to get additional banks as members.

To make effective any power to deal with this subject it seems to me that it should be all-inclusive insofar as reserves are concerned, leaving actual membership as such optional. There should be such a thing as maintaining a reserve without being required to comply with the rules of membership that might be optional. The important thing is to have an over-all control of the reserves if this is to be effective.

Another point of importance is one which, it seems to me, would be a part of any such program. That is that the reserves that are carried with the Reserve System in order to meet the requirements should be free or exempted from the deposit insurance assessment on such reserves; that to continue to lock up a greater and greater amount of the bank deposits in the Reserve System, where, of course, they cannot be used, and then to require banks to pay a deposit insurance on those funds would hardly be a fair or equitable thing to do. It seems to me that that is another point that should be stressed.

I tried to state in just very general terms without getting into too much detail on this question——

The CHAIRMAN. Incidentally, the amount of reserves required would not have any effect on the liability of the banks to their depositors, would it? You could not by raising the requirements regulate the liability of these banks to their depositors?

Mr. ECCLES. That is correct. You could not in any way.

The CHAIRMAN. Let me ask you just what you mean by "over-all credit."

Mr. ECCLES. I mean over-all as against what may be termed "functional installment credit" or "functional control." Just as our control over—we have a very direct control, selective control is possibly the better word, over broker and collateral loans. That control was given to the Board, I think, in 1933. Now, that is a direct or a selective control over a particular type of credit. The selective credit control is likewise a selective control outside of the bank control of credit. What I term a "functional control" would be a control over the reserves of the bank that would tend to have the effect of creating a climate in the whole banking structure less favorable to a further credit expansion.

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The CHAIRMAN. What is the situation now with respect to both the loans and the authority to restrict the Federal Reserve? What is the situation now?

Mr. ECCLES. There has been no change in that in the statute, and there has been no change of the current regulations on that since 1937. The stock market now is almost on what might be termed a cash basis and not a credit basis. There is very little use of credit on the part of the public or the brokers for the purpose of buying and holding securities.

The CHAIRMAN. Would you anticipate any development that would bring about the necessity for further use of the powers of the Reserve to restrict local loans?

Mr. ECCLES. Not yet, I would say. I see no prospect at the moment where the Board would have to use the powers for that.

The Board has, I believe, adequate powers to deal with any situation that would develop through the use of credit in the securities field. The Securities and Exchange Commission through their regulations, and particularly their regulation of brokers, and also through the regulation of the underwriting and selling of investment securities, has possibly done more than our regulation has to put the security market pretty largely on a cash basis.

The CHAIRMAN. And that situation will probably continue?

Mr. ECCLES. I would think so.

The CHAIRMAN. Excuse me, Mr. Williams. I didn't mean to interrupt.

Mr. WILLIAMS. You think that in addition to the over-all control already mentioned to the fiscal monetary policy of the country it is necessary to have a direct-control process?

Mr. ECCLES. I think it is absolutely essential. I think that there is no possible use of functional controls no matter how numerous that could substitute for the use of price controls in certain fields. Those fields are going to become more and more extensive as purchasing power continues to increase.

Mr. WILLIAMS. If I understand you, you are in favor of selective-price control rather than putting a general price ceiling on all commodities?

Mr. ECCLES. That is right. I favor a selective price control, for two reasons.

My first reason is that Mr. Henderson and his organization, who have had some concern in this field for the last few months, and who have no doubt made quite an extensive study of the problem, favor selective-price control as being the most practical of administration.

Based upon my limited analysis and knowledge and lack of practical experience it would appear to me, at this stage, certainly, that a selective-credit control is preferable.

It may well be that a point will be reached before we get through where an over-all price control may be required to meet the problem. I don't think that we are at that stage at the present time.

Mr. WILLIAMS. Of course, it has been suggested many times that in order to have a general over-all ceiling we are confronted with the proposition of placing in the first place in the law some kind of a wage schedule fixing the maximum amount of wages, if that can be done. Now, do you think that Congress can fix a price on wages, just like it fixes a price on a bushel of wheat or a pound of copper or a ton of steel?

Mr. Eccles. I think that is much more difficult—to put a price on labor—than it is to put a price on commodities.

Mr. Williams. The question I am asking you is whether it can be done.

Mr. Eccles. I think that there are countries in the world that it has been done in, and I think it can be done. But I doubt if it will be done in this country.

Mr. Williams. Has it ever been done in any country with a written constitution which says that slavery or involuntary servitude shall not obtain?

Mr. Eccles. Of course, I don't think so. I know of no case where it has been done.

Mr. Williams. In my mind I am thoroughly of the conviction that it essentially cannot be done. However much we may desire such an objective, it is my conviction that it cannot be done. Now, if I am wrong about that, I would like to have somebody else tell me where it can be done.

Mr. Eccles. If we get to the point, of course, of drafting all industry and all labor, I suppose it could be done, just as it is done in the case of the Army. But it is going to be pretty difficult to do it, to fix a wage on every category and every classification of statute.

Mr. Williams. We have, of course, the constitutional provision which provides that Congress shall have the power to raise and equip an Army. Of course, we have the right to draft into the Army men. We have the right to draft men in industry for the Government in order to equip the Army under the provision in the Constitution. But what I have in mind is trying to fix a wage schedule, a wage price, for which labor shall work in private industry.

Mr. Patman. Do you contemplate compelling them to work for that wage or permitting them to work for it?

Mr. Williams. I am asking whether he can fix a wage, yes, and compel them to work for it.

Mr. Eccles. I don't see how it would be possible to compel them to work. You might fix a wage for which they could either accept it or quit.

Mr. Williams. Yes. And they can now do that by agreement.

The wage structure is based entirely upon a voluntary wage, is it not?

Mr. Eccles. The difficulty is, however, that so long as an industry can increase its prices which it can do to meet an increased demand for goods, it has very little objection to increasing the wages, because the net result is that it increases those wages and salaries rather than having a strike and stopping production, and particularly when it does not cost them anything because it can pass that increase right on to the consumer.

So that the negotiations that are carried on between industry and labor in a great many instances are not really effective negotiations in the public interest. The public, who really is affected by the results, are not even represented in those negotiations often. We get the spiral of wages and prices, which are public concerns, and even the labor itself not concerned with the public.

So that the mechanism of the negotiation between each company and its labor is fine in theory and it works well under a normal condition possibly. But under a condition of shortages of certain categories, it just does not work out well. Labor and capital are not always interested in these negotiations. It seems to me that there has got to be some way of protecting the public interest as well in those negotiations.

Mr. WILLIAMS. Don't we have Government boards to supervise that which are supposed to represent the people?

Mr. ECCLES. I don't know what the boards may be. But no board has concerned itself with what the wages are and what the agreement may result in.

Mr. WILLIAMS. We have the National Labor Relations Board and the Conciliation Board and the Mediation Board.

Mr. ECCLES. That is right. But they merely have supervision over the machinery for negotiation. But if labor and industry agree, they are not concerned with what base of wage they are given. Industry is not so much concerned if it can add all the cost onto the price.

Mr. WILLIAMS. You think there is a collusion, then, between labor and industry to raise wages?

Mr. ECCLES. No. I don't say that there is collusion. I would not call it that. I think it is a natural result; that if an industry in order to avoid a strike whereby it could be shut down, and it does not have to absorb the increase of wages, we will say, out of its earnings, but can pass them on, it is naturally going to follow the line of least resistance and make the grant.

Mr. WILLIAMS. But you think that wages have been fixed too high?

Mr. ECCLES. I would not say that. I am not talking about the justice or the injustice of wages. I would like to see wages always, the income of the people, sufficiently high to buy all that we can produce, so that we can have full employment.

So that in raising the question of wages, I am not making a defense for capital here, I am trying to argue the inflation implication of the present predicament that we find ourselves in.

Mr. WILLIAMS. That is exactly what we are confronted with. We are confronted with the proposition as to whether or not we should put in this bill a ceiling on wages or give the Price Administrator, if you please, the power to put a ceiling on wages beyond which they shall not go.

Mr. ECCLES. As I understand the position of the Price Administrator, the one who is now directing the administration of prices, he does not desire to deal with this subject in this bill; and I would suppose that the job of administering prices in and of itself was possibly sufficient without also having the wage problem and the agricultural and all the other problems in it.

Now, the question of a ceiling on wages is a little different, quite a different matter. You have a great variety of skills engaged in labor. You have very different conditions, of course, in various parts of the country. It may be that a ceiling, unless it happened to be a ceiling of the various classifications in various sections of the country, may likewise prove to be the floor. There is that problem that would have to be taken into account.

I think that some mechanism has got to be found, as I indicated this morning, to more nearly centralize the dealing with this problem;

that the public interest has got to be represented before, we will say, an agreement may be made between an industry and labor, because the public interest very often is affected by it.

Mr. WILLIAMS. Then you would change our labor policies that have been enacted by Congress, we will say, during the last 10 years?

Mr. ECCLES. I would certainly streamline them to meet the present conditions, just as in the credit banking field.

Now, whereas we thought of the ceiling type of program in a deflation, we today realize that to continue to pursue a policy of Government employment in W. P. A. and P. W. A. and to continue a program that attempted to induce spending instead of saving, would just exactly be the reverse from what we want.

So that in the labor scheme, as in the agricultural and other schemes, it may be necessary to make some changes. I am not an authority on the subject, but it certainly does seem to me, based upon the results that we are getting, that some changes may be necessary to deal with the situation that exists.

Mr. WILLIAMS. As I understand you now, you think that the labor policies need revising; but you don't advocate placing it in this bill in connection with price control. Is that right?

Mr. ECCLES. Yes; I am not advocating that they be placed in the bill, if the Administrator thinks that they should not be there, that this is a problem of administration which should be elsewhere.

I would not want to say that this bill should try to cover that, to be all-inclusive, we will say, in dealing with the whole economic front, because if you are going to place in a bill on price control the labor question, there is not any reason why you should not place in it this question of farm prices and all the other measures that may be necessary in order to deal with the functional aspects of inflation.

Mr. WILLIAMS. During the years Congress has built up what might be called a labor policy which is fairly well defined.

Mr. ECCLES. That is right.

Mr. WILLIAMS. Now, you don't entirely agree with that under present conditions?

Mr. ECCLES. I would not want to put it that way. I have been favorable to collective bargaining. I have been favorable to the right of labor to organize. I have been for machinery that would make it possible to protect labor in that.

I have been favorable as long as we had a lot of unemployment to a 40-hour week. I was favorable to a minimum wage when there was a period when the pressure of unemployment was likely to force wages to unreasonably low levels.

I was favorable to reducing the taxes on labor for social security when we needed increased purchasing power. I was favorable to providing very low rates and long terms to enable labor to get the benefit of housing. I have been favorable to decreasing the consumer taxes to the very maximum so as to increase the purchasing power of labor, and farmers for that matter. I have always been an advocate of putting the tax system on the basis of ability to pay.

I am still thinking of the interest of labor, the interest of agriculture, where I talk, as I do, about trying to prevent inflation. But if wages and agriculture prices are packed into the picture, it just can't be helped.

In answering your questions I have tried to avoid the implication that I think it might have carried, that I am opposed to the interest of labor or agriculture.

Mr. WILLIAMS. As I understand you, Mr. Eccles, you have been in favor of all these policies which you have announced; but you believe that under the circumstances that exist now under this emergency they have more or less broken down and they are not sufficient and there should be some change made in them?

Mr. ECCLES. Yes; I could say that. Certainly something has broken down, and the problems are not being met. Now, whether it is something that has broken down or we need something additional, I don't know.

Mr. WILLIAMS. Have you any suggestion to make as to what should be done to make the existing legislation remedy that situation?

Mr. ECCLES. No, sir. I have not.

Mr. WILLIAMS. Let us see about the farm situation. This bill proposes to set a ceiling on farm prices as well as all other commodities, I mean, the price of farm commodities, if those prices rise to a point 10 percent above parity. Is that your understanding of this bill?

Mr. ECCLES. That is my understanding.

Mr. WILLIAMS. Are you for that or not?

Mr. ECCLES. I am favorable to a ceiling on agricultural prices. As to whether it should be parity or 10 percent above parity I am not prepared to say. But certainly there should be a ceiling at this time on prices. If labor and income and business profits continue to go up, certainly that ceiling should be raised accordingly.

Mr. WILLIAMS. Would you be in favor of placing a ceiling on the price of farm commodities below the parity price?

Mr. ECCLES. No; I would not.

Mr. WILLIAMS. You would not set farm prices until they reached parity?

Mr. ECCLES. I would not.

Mr. WILLIAMS. If some of them went above parity, it was your thought that a ceiling should be set?

Mr. ECCLES. As I said, it is a question. I don't believe that I am able to answer it. Whatever price farm products may be fixed at, it should be a fair price in relation to other things. Whether that is parity or 10 percent above parity I would not be prepared to say. But certainly there should be some price at which the prices should not be permitted to go further.

Particularly is that true if there is going to be an inflation. A floor has been put on prices for some time, and it is only fair that there should be a ceiling put on them.

To the extent that surpluses have been accumulated and are held in storage by Government agencies, certainly those goods that may be held in storage should be released in order to keep prices down, to keep prices from going above parity.

I have in mind, of course, wheat and cotton in particular. It seems to me folly to take surpluses off of the market in a time of depression in order to keep prices from falling further and then not use those surpluses in order to keep prices from likewise going too high. I was very much in sympathy with the Presidential veto of the bill that did just that.

Mr. WILLIAMS. Why put in this act at all anything about parity?

Mr. ECCLES. Because this is a bill that is dealing with the price of commodities. It is a bill that deals with neither profits of business or individuals, nor with the wages and salaries of labor.

You, of course, could leave parity out of the bill and include farm products, leaving the discretion up to the Administrator. But I cannot believe that it would be possible to get such a bill through unless there is some indication of the basis upon which prices can be fixed.

Mr. WILLIAMS. Then if we put parity in the bill, it seems to me that that is the basis upon which the Administrator would be guided in determining what is an effective price on any farm commodities, that is, a measure of it. He must be regulated by that standard.

Mr. ECCLES. I think that is correct.

Mr. WILLIAMS. And under the present terms of the bill he would simply be given the discretion to fix that price. Then the commodity, if it got out of line, could not exceed 10 percent above parity. That simply gives him, as I see it, that leeway between the 100 and 110 percent on the price that rose above the parity level.

Mr. ECCLES. I think that that is desirable, and that provides a formula or a guide which I think any administrator would find most helpful.

Mr. WILLIAMS. I think that is all that I have at the present time.

The CHAIRMAN. Mr. Crawford?

Mr. DEWEY. May I just ask one question in connection with what Mr. Williams just asked?

Mr. CRAWFORD. Yes.

Mr. DEWEY. This is in order to go along with Mr. Williams' question.

If we found that there was an organization of some labor board or group similar to that which you describe, do you think it would be advantageous to the present Administrator to be seated with that board in connection with the price of wage disputes that might arise, he being very familiar with the correlation of the costs in the various fields?

Mr. ECCLES. Yes. I think it would be very desirable, because I don't see how that price administrator can fix a price on a product that can be maintained in the face of increasing wages. I think that there is certainly a very close relationship; and that in the consideration of prices to be fixed it is very necessary, it seems to me, to consider the wage policy in connection with any industry affected by price increases.

Mr. DEWEY. Thank you very much.

The CHAIRMAN. All right, Mr. Crawford.

Mr. CRAWFORD. Just a few moments ago, Mr. Eccles, you dropped a remark about the provisions of this bill which prompts me to ask you this question:

Did I understand you to say that the bill does not in any way provide for or obligate the Administrator to look at profits, the profit margin?

Mr. ECCLES. Yes.

Mr. CRAWFORD. I judged that from what you said a minute ago.

Mr. ECCLES. I may be wrong. I am not an authority on this bill. But it is my understanding that this bill did not undertake to regulate the profit of the business.

Mr. CRAWFORD. That is my understanding. As I interpret its provisions, it in no way obligates the Administrator in the setting of a price ceiling to guarantee any real net profit to the operator.

Mr. ECCLES. That is my understanding of it.

Mr. CRAWFORD. Mr. Williams, I believe, was interrogating you with reference to this Executive order and the rules issued by the Board to somewhat curb consumer installment credit. I want to ask you a few questions on that.

I have here a one-page ad which appeared in one of the daily papers. It starts off—

> Uncle Sam says credit buying may be continued. The impression seems prevalent in some quarters that the Government has forbidden installment buying. There is no basis for such a conclusion.

Then it goes on with considerable argument. This is signed by some 13 contributors that deal in installment credit goods.

In here are some sheets torn from one of the New York papers. Several ads appear on these which have been placed in the newspapers by installment loan companies soliciting additional business.

Those ads prompt me to ask you two or three questions with reference to this new field, which you spoke of awhile ago as being greatly involved; and I believe your language is something to the effect that there are tens of thousands of businesses affected in the picture.

Could you give us as briefly as you care to, maybe, the real purpose of the Executive order which set up this credit control?

Mr. ECCLES. Yes. I will try to do that as briefly as possible, to give you my conception of the control of installment credit.

It seems to me that to be able to defeat a dampening of consumer buying power by taxes and by social security or by an inducing by the Government of savings, merely to be offset by the easy use of installment credit, was attempting to close one door and leave the other wide open.

You cannot effectively, it seems to me, reduce the buying power through taxes or other means and leave not only the installment credit field wide open but every other credit field. It seems to me that you are offsetting through the increase of credit what might be absorbed through the application of taxes or other means. And therefore the problem is an over-all problem, and the consumer credit is one aspect of it which happened to fall in our basket, because we dealt with the credit picture.

Now, we certainly have not the remotest interest in affecting production. It would be a great mistake to restrict the use of credit where what is being produced is finding a market. What we are trying to do is—because of a restriction in production or because of a production which is inadequate to meet the consumer demand—we are trying to reduce the consumer ability to buy. We thus reduce the consumer demand through contraction or curtailment of installment credit.

Now, it is an illogical situation, but a true one, that credit contracts and is paid off in a deflation and expands in an inflationary period, when you don't want it to.

At this time, when wages and salaries, incomes, generally, agriculture and business incomes, are the greatest that they have ever been, we have found all through the past year that installment credit was increasing at an unbalanced rate.

Mr. CRAWFORD. Right at that point, do you recall what the volume was last year?

Mr. ECCLES. I don't know. I can speak in general terms. As I understand it, the average amount of total outstanding consumer credit was about $10,000,000,000 along about July, at the time this order was about ready for signature. At that time it was about $10,000,000,000.

Now, a substantial part of that, maybe $3,000,000,000, was what we call open-market consumer credit. The other was in various other forms.

That outstanding consumer credit was advancing and was increasing all spring and summer at a pretty rapid rate, something over $100,000,000 a month. So that we were really adding to purchasing power to the extent that that credit was expanded.

How effective a control might be, of course, depends upon the tightness with which the regulation is. It depends upon the restriction that you may place upon consumer credit through a modification of the regulation and upon the tightness of administration, upon what is practical.

Mr. CRAWFORD. On that point, you have restricted all sales to not to exceed 18 months. Is that right?

Mr. ECCLES. That is correct.

Mr. CRAWFORD. Could we say fairly that that is a beginning order looking forward?

Mr. ECCLES. That is a beginning order. That is right. We would expect each move in the future would be a tightening process. But a purpose test seems to us essential before an effective tightening order can be carried out.

Mr. CRAWFORD. You said this morning, I believe it was, that this is having a tremendous use. Would you care to say further that in drafting this beginning order initiating this problem the Board did work closely with the representatives of the installment finance companies?

Mr. ECCLES. Yes; we did.

We have been studying the question of consumer credit for a long while. We were conscious of what happened at the end of the twenties in that field and its direct inflationary effect in the thirties; likewise in 1936 and again in 1937.

It is a great deal like the inventory picture. As prices began going up, there were these great accumulations of inventories on the expansion of consumer credit that was just outside of the bank credit. Then in a deflationary period buying is stopped and inventories are utilized. As consumer-credit expansion is stopped, production is stopped, and you have two very potent forces making for deflation. We are thinking of it from that standpoint.

It was very apparent that the field of installment credit has been growing more and more lax, not so much in the use of bank credit, because the volume of funds already is so great that many institutions have far more funds than they can use, and they are making all kinds of credit terms in crder to sell their merchandise and likewise to utilize their funds. There is about as much interest with many concerns in getting the interest on installment credit as there is in selling the marchandise.

So that there was a field in which we found that using the velocity of money in the banks, we had further expansion of consumer credit in that field. Therefore, the only way that we could get it was through the restriction of terms upon credit institutions outside of the banks.

In order to try to meet this problem in a practical way and try to get cooperation, we were working very closely with Mr. Henderson and with two installment-credit men, one in particular, Mr. Nugent, head of the Russell Sage Foundation. He is in our staff. He brought in all of the various interests—the installment-credit finance companies, the personnel finance companies, the banks, the furniture dealers' associations, all of the various groups.

We brought them all in, and we had conferences. So that they had an opportunity at least to express their views, and they knew what the purpose of this whole thing was.

Of course, they have a personal financial interest, and they would like to see the regulation, I think, most of them, so drastic that it might help to make what would be termed "a pattern of ethics for installment credit."

But we were not primarily interested in that phase of the problem. We cannot be an N. R. A., so to speak, for the installment credit business. We have tried to make them see that, and up to the present time, I think, we have pretty full cooperation, considering the complexity and the extent of the problem. How much attempt at evasion there may be when we begin to tighten this thing will depend, I suppose, upon how drastic the regulation becomes.

Mr. Crawford. Under the present proposal are you going to issue licenses?

Mr. Eccles. We will. As I understand the Executive order, all of those who extend installment credit, as defined by the order, automatically have a license to do business. Then they must within a certain period comply with certain requirements and be given a license. And one of the penalties for failure to comply is, of course, taking away their license, which prohibits them from doing an installment business.

Mr. Crawford. You blanket them in and then depend upon them to conform?

Mr. Eccles. That is right.

Mr. Crawford. You spoke about some of these companies having such a supply of funds on hand. Did I understand you correctly that it is no longer necessary for them to rediscount their paper at the bank?

Mr. Eccles. Yes.

Mr. Crawford. Would you mind giving us, if you have the figures in mind, the minimum and maximum interest rates charged by the companies doing a merchandise business and those doing a personal cash loan business?

Mr. Eccles. I really haven't the figures in mind. We didn't approach this, Mr. Crawford, from the standpoint of affecting their method of doing business.

Mr. Crawford. I understand.

Mr. Eccles. Their financial method.

Mr. Crawford. In other words, you were interested in the volume of goods that might be sold through this method?

Mr. Eccles. Yes. We were interested in seeing that the total volume of installment credit was greatly reduced.

I have said this—that if the total amount, this $10,000,000,000 of outstanding credit, could be reduced as much, we will say, over the period of the next 2 or 3 years, so much that we could actually reduce it by $5,000,000,000, that would be an equivalent of $5,000,000,000 of savings. By that you would have built up a backlog for purchases when this thing is over, of a great proportion.

To the extent that the total amount in consumer credit does not diminish and further expands, just to that extent the problem of post-defense deflation will be increased. So it is important from that point.

Mr. Crawford. If a new company should come into the field, say, subsequent to this date, as an illustration, they would have to obtain a license based upon your investigation of the standing of the company, would they not? Or have you gone that far?

Mr. Eccles. I could not answer that question.

Mr. Crawford. That may be something that we have got to meet in the future?

Mr. Eccles. That is right.

I interested myself in this thing very actively in the development of the Executive order, in the getting out of the regulation. It is a full-time job, and the matter has been handled by Mr. Ransom, who is vice chairman, as I have been away. I am just a little bit stale, I think, on the whole complicated thing.

Mr. Crawford. Do you know whether the regulation covered both installment sales and personal loans?

Mr. Eccles. Yes. It does.

Mr. Crawford. It covers both of them?

Mr. Eccles. Yes. Both cash loans and, of course, installment sales—cash loans up to a thousand dollars; not above that. It is limited to a thousand.

Mr. Crawford. I wish to ask you some questions with reference to the Board of Governors' procedure, if I may call it that.

Would you care to express yourself as to the advisability of increasing the rediscount rates and make that increase optional to all transactions other than what you might term "defense transactions"?

Mr. Eccles. I think that an increase in the rediscount rates would be meaningless.

Mr. Crawford. Under present conditions?

Mr. Eccles. Yes. None of the member banks are borrowing from the reserve banks and have not done so for a good number of years, except in a few isolated cases and to a very limited extent.

Mr. Crawford. In other words, that is a question that it might be proper to raise in event excess reserves should disappear?

Mr. Eccles. That is right, to the extent that excess reserves were substantially reduced, or, as you say, did disappear.

Mr. Crawford. Then we might say—and I think that this would cover it—that that would govern until the banks get back into their borrowing position?

Mr. Eccles. That is right.

Mr. Crawford. In other words, it is meaningless until they reach a position where they would want to borrow?

Mr. ECCLES. Of course, even then some may reach a position where they would have to borrow or dispose of certain assets. In that case they would either contract some of the excess that they had or dispose of some of their securities, or do part of each. That is more likely what they would do, rather than borrow from the Federal Reserve, and in that case other institutions having excess funds may buy securities, for instance, Government bonds that were sold. If they did not, the Reserve System, under a situation of this sort, would have to stand ready to take such securities that were sold off of the market, in my opinion, and that was the difficulty in 1937.

We have heard it said, and in this connection I would like to repeat, that there would not have been the situation that was created in the Government securities market in 1937 had the open-market committee not failed to meet the situation after the Board had acted on increased reserve requirements. Here was a case where one body had the power to increase reserve requirements, and where another body failed to meet the situation which was created in some banks as a result of that increase and use the more flexible instrument of open-market operations and put the funds where they were needed by buying the securities that were being offered at that time, at least buying them on a gradual scale.

However, the market went off very substantially, and the open-market committee purchased practically no securities at all. They were confronted with either a desterilization on the part of the Treasury to meet the problem, or a reversal of the action on the part of the Board, and when they were confronted with one of those two things, then an undertaking in the open market was carried out and the whole situation changed and there was a purchase of about $96,000,000 of Government securities.

So often the failure of the Board because they increased reserves in 1936 is referred to, and I merely say that that whole pattern was not carried out as it should have been.

Mr. CRAWFORD. Now, this morning you mentioned some of the statements that you made, including the articles in Fortune magazine, and I have been following those very closely and have been much interested in them, and I will say to you, as a Member of Congress, that I think we have committed a tremendous error in not paying more attention to what you said and taking positive action on your recommendations; but we cannot do much about that at the moment.

Now, let me ask you this question, if you care to answer it: Do you believe that Congress should consider legislation right now to permit further increases of reserve requirements, subject to the limitation that they shall not be increased to more than double the maximum requirements under the present law?

I think that that is referred to specifically, that formula, in your report of about last December.

Will you give us a comment on that?

Mr. ECCLES. Yes. It is rather difficult to avoid a comment on it under all of the circumstances. As I stated this morning, any increased powers over the reserve situation, over the over-all credit association, presents a matter in which the Treasury, with its large amount of financing necessity, is tremendously interested.

For that reason, if increased power, whether the kind is indicated or in some other form, were given to the Board as an independent agency, not that the Board would act without consultation or consideration with the Treasury, but if that power were given, the Government financing situation could be very greatly affected by any action taken, and therefore its inflation problem and monetary and fiscal problems are so interwoven that any recommendation that may be made to this committee with reference to monetary legislation should be made with the approval of and in conjunction with the Treasury.

Otherwise I do not believe that effective results could be secured.

Does that answer the question?

Mr. CRAWFORD. I think that that is correct, and I agree with your observations in that respect.

But let me say it this way: Assuming that Congress will draw the legislation in such a way that left it entirely to the discretion of the Board working in conjunction with and coordinating with the Treasury Department, are you in position to recommend to the committee that it now consider or enact legislation which would authorize the Board to, using this same language, increase reserve requirements, subject to the limitation that they shall not be increased more than double the maximum requirements under the present law, and let you and the Treasury proceed to work out what you want to do after that type of legislation is enacted?

Would you go so far as to recommend to us that we give you that authority?

Mr. ECCLES. No; I could not; I would not at this time do that; and let me just read what I assume you have heard before, and I think that this is possibly a full and complete answer to the reasons why I could not answer your question.

Mr. CRAWFORD. Are you referring to the joint statement?

Mr. ECCLES. Yes.

Mr. CRAWFORD. We have that in the record.

Mr. ECCLES. It is—

> Recommendations on the question of what additional powers, if any, over bank reserves the Board should have during the present emergency, and what form these powers should take, will be made whenever the Treasury and the Board, after further consideration, determine that such action is necessary to help in combating inflationary developments.

So that in the light of that statement, and in the light of the conferences and the consultations that the Board and the Treasury have been carrying on for some months, it would seem inadvisable and contrary to the understanding as expressed herein that either me or the Board should make any recommendations with reference to this subject of bank reserves.

Mr. CRAWFORD. I understand from that joint statement, and your other remarks, that you would not care to further state under what conditions the Federal Reserve Board would utilize any additional powers to increase reserve requirements that we might approve, and I understand further from your remarks that you do not see at the moment any definite yardstick or that you do not care to further develop or expound on your philosophy that has been agreed upon between the Board and the Treasury for the future application of such legislation if it should be enacted?

Mr. ECCLES. Yes; but it seems to me that that question is making an assumption that I do not believe is possibly correct.

Mr. CRAWFORD. Let us get it corrected.

Mr. ECCLES. It is assuming that the Treasury and the Board have got some definite program and agreement with reference to the present and the future. The whole situation is one that is subject to constant change, as you know, and is subject to a continuous study, and the particular aspect of this problem that concerns the Treasury, of course, is, How can a more restricted money policy be introduced by dealing with the excessive reserve situation without, say, adversely affecting the Government securities market and making it impossible for them to finance this defense program?

So there is a question of a serious dilemma, in a sense, although I think that the dilemma is one that can be met, and I think that the British situation in that regard, although there are some differences, and yet they have never maintained any substantial amount of excess reserve over a long period of years, might be referred to. They completely control the money market and succeed in financing the Government. I think the rate is 2¾ percent for the long-term securities.

So that I think that there may be ways and means of meeting this problem, and I am sure that the Treasury are conscious of it and are just as anxious as anyone can be to do whatever can be done on the monetary front and the fiscal front to prevent inflation.

Mr. CRAWFORD. Do you believe that there is an adequate market today for these new requirements or needs of the Treasury outside of the commercial banks?

Mr. ECCLES. Well, to what extent?

Mr. CRAWFORD. May I say this to you, that I do not suppose that you have had time to read the record, but as I remember the figure, Secretary Morgenthau made this statement, roughly, that during the next 9 months of the current fiscal year he may have to issue as much as seven or eight billion dollars of new paper, and of that amount, perhaps as much as $300,000,000 per month, or, for the 9 months, $2,700,000,000, might be disposed of in the form of defense bonds.

My question is, Do you have reason to believe that an adequate market can be found outside of the commercial banks for these new nonrefunding issues?

Mr. ECCLES. I think that there is a much greater market than has yet been tapped. Whether it would be completely adequate, I think, can only be determined by trial.

As I recall the figures at the end of the last war, the total supply of your demand deposits and currency, which I speak of as our effective money supply, was about $28,000,000,000, whereas in the first part of June it was around $45,000,000,000 in this country. It had increased nearly seven billions in the last 12 months, and the increase by the banks in their holdings of Government securities during that period was equal to practically the entire increase in the Government debt. It appeared that the banks were taking all of it in the aggregate, and so there was this pumping up of the supply of money accordingly.

Since June I do not have the figures, and I do not know what the increase is, but I have no reason to believe that the increase is not just as rapid as it was previous to that time, and that we are continuing to rapidly pump up our means of payment.

Of course, there is no real danger in the total volume of money if it lies idle. The danger comes when the owners of the money begin to lose confidence in its purchasing power, and start to get rid of the money to buy things, just as in a deflationary period everybody wants to have their money, because the prices of things are going down and the purchasing power of money is going up. The greater the increase in the supply of money, the less it purchases.

There may be a point when, after the supply has increased to a far greater extent than it has, that it then would get into velocity and would do considerable damage. If the existing supply of money is being utilized, is going into the Government, and the Government puts it out, it does not diminish.

The point that most people fail to realize is that when the owners of funds, outside of the banks, purchase Government securities, that those funds do not disappear, but go right back into individuals and corporations. The Government does not take the money from the sale of bonds and then bury the funds and fail to put them out, or hold them on balance in the Reserve System. The Government is putting those funds out, so that of this seven billion dollars that has been borrowed, the first billion has been put back out, and has to be borrowed again.

So it is a question of tapping the existing supply of funds, primarily, and if on a volume of $28,000,000,000 we should charge higher prices than we now have, it would seem to me that the present volume of funds could do very much more work than is now being done.

The Treasury, I think, has done an excellent job in its defense savings bonds. That is starting really to be effective, and there are the tax-anticipation warrants and other ways that I can think of in which some of these funds can be tapped.

Now, if it is found that that could be done, and that the open-market financing was unnecessary, or at least greatly reduced, then the problem of reducing excess reserves would not be so worrisome. It would seem to me that the Reserve System, in fairness to the Treasury, would have to stand ready with its open-market function to assure a successful Treasury financing at a rate that was fair and an adequate rate under the circumstances.

Mr. Crawford. You referred to the British rate at the present time as 2¾ percent. Are those issues on tap at all times?

Mr. Eccles. I think so. They are tap issues.

Mr. Crawford. That is the only issue out at the present time, I believe? That is the only one being offered now?

Mr. Eccles. That is correct. That is the long issue. The Treasury, to fill in, offers or allocates to the banks, and that is a much simpler problem there, because there are only four or five banks, with many branches, and there are fewer people to deal with, and the banking system works very closely with the Bank of England and the Treasury.

What they do, as a practical matter, is that they give to the banks a short-term 6 months' bill and give them an arbitrary rate. They do not figure the market rate at all, because the market just is a controlled market. So they give them 1⅛ percent for a 6 months' bill.

In talking to Mr. Maynard Keynes, who was over here for a time representing the British Treasury, I said, "Isn't that a pretty high rate?"

He said:

We over there look upon that as a necessary rate to maintain the credit system. The credit system is a part of the capitalistic system and must be maintained, and that is the rate that is looked upon as a rate necessary to help maintain the credit system and to keep the banks out of the long-term market, and the banks do not go into the loan market.

They give them these short securities—they are merely a stopgap—to fill up in an interim period between tax periods, possibly.

So the banking system is used with that flexibility in the short market.

Mr. Crawford. Then by creating other credits that might be adaptable to our banking system your thought is, then, that we might take our forty-two or forty-six billion dollars of funds, demand deposits, plus currency, and perhaps greatly assist our own program, if it becomes necessary?

Mr. Eccles. Yes. My thought is that that volume of funds can do a much greater degree of work than is being done now.

Mr. Crawford. I think that it was in your Fortune article that you dealt with the Treasury selling a long-term registered security bearing interest, I believe, at 2½ percent in unlimited amounts to large investing and institutional concerns other than commercial banks.

Could you give us further details on the terms of these securities, which, I believe, you somewhat recommended, and would they be free of market risk to the purchaser and redeemable at any time at the option of the holder at the Treasury at a fixed rate?

Mr. Eccles. My thought was that series G, with $50,000 as the limit, would have a rate of 2½ percent if the security is carried through for 10 years to maturity. The $50,000 does not come even close to meeting the demand of a lot of institutional investors, and my thought was that that series should be supplemented by another series of 2½-percent securities, because the pattern of the rate has been pretty largely established by savings securities that have been issued, and the 2½-percent security could be made available primarily to anybody without limit, the Treasury always reserving their right to accept or decline any subscription, of course, with a much longer term.

I do not know as to the term. We might say 15, 20, or 25 years, but at least in order to get the 2½ percent, it would have to be carried to maturity. It could be cashed in, just as a series G bond is cashed, after a certain period of time, you may say after a year or 6 months, by giving notice, 60 days' or 6 months' notice, an adequate notice, but if cashed in it would be cashed in with the interest rate paid on it bearing a relationship to the period held.

Now, the savings banks, the insurance companies and many of the trustees, both institutional and individual, have great quantities of idle funds, and the capital market has almost disappeared, because the whole activity of the heavy-goods industries is pretty largely in the field of defense. So the private investment capital market is more and more becoming a Government market, and therefore, in the absence of private securities and mortgages of all kinds, and there is a great absence of them, and an increased national income, which means that we want to stimulate savings and increase insurance, and so forth, it seems to me that securities by the Government possibly should be provided in some way at some maturity that would be adequate to absorb those funds.

That was what I had in mind in making that as one suggestion in helping to utilize a lot of these funds which are now idle in the banks.

Mr. CRAWFORD. Let me press that a little further. Do you believe that by putting out an issue of that type, putting it on tap at 2½ percent for 10, 15, and 20 years, whatever it may be, and making it nontransferable and subject to being cashed in after a certain time specified, that that type of institution would buy that type of obligation more freely than they will buy open-market issues?

Mr. ECCLES. Yes; I think they would, and, further than that, you cannot make open-market issues without depending upon the banks as underwriters.

Mr. CRAWFORD. That is right.

Mr. ECCLES. And you have to offer the issue at some premium, and then the amount that anyone can subscribe for is limited, so that the insurance companies and these other institutions have to depend upon a secondary market in which to buy securities, and when they fill up their portfolios they bid up the market until it is at 2 percent, and the two issues put out this year, the taxable issues, are selling on a 2-percent basis, and the institutions, in order to get those, have to get them through the underwriters from the market at a lower yield basis.

Now, that is one of the problems that the open-market financing creates. There may be open-market financing—I am not opposing it—to whatever extent it is necessary, but there is this problem in connection with the open-market financing—that in pricing your market financing, the more of that type of financing that is done, we will say, at a lower yield basis, the more you get to the point where the last financing that is done at the lowest basis is the basis that is almost necessary to hold it at because otherwise the holders who have purchased substantially of the issues would then have an immediate loss on them; and if that happened during a period when the Government was in great need of open-market financing, it would find greater difficulty in its open-market financing to the extent that the last issue was selling below par.

That seems to me to be one of the practical problems.

Mr. CRAWFORD. In your opinion, would that type of issue appeal to these institutions a little more than an open-market issue would by reason of the market risk involved in the open-market issue?

Would you go so far as to say that?

Mr. ECCLES. Well, I think that it would.

Mr. CRAWFORD. Along with other things, I mean.

Mr. ECCLES. Yes; I think that that is true, but I think that it would also reduce the problem of open market——

Mr. CRAWFORD. Yes.

Now, I was going to ask this, but I do not think it is necessary because this morning, I think it was, you enlarged on your thought as to the demand pull that might develop on the Treasury at some subsequent date by reason of these holders of nontransferable securities calling upon the Treasury to redeem. You simply pointed out that in a time like this, if the Treasury did that, it might be able, by issuing deficit securities, to do other things, so that this would come in the same category, would it not?

Mr. ECCLES. What it would amount to is that at this time institutions, Social Security, and individuals are investing and the Government is borrowing those savings. If the reverse were true, and they begun to cash them, it would mean that they are using those funds to provide employment. So the Government, in turn, would be merely refunding this type of security—this type of saving. The Government would then put out another issue. It would be a refunding operation.

So that if I wanted to cash in my securities, and that means that I would want to spend my money, the Government would give me the money, refund that security by going to the market, but the funds that I have spent are in the hands of somebody with which to buy the securities.

Mr. DEWEY. Mr. Crawford, will you yield for a question at that point?

Mr. CRAWFORD. Certainly.

Mr. DEWEY. At that point I was thinking over, Mr. Eccles, your reply this morning relative to that subject, and, if I recall correctly, the Fifth Liberty Loan had a coupon rate of 5 percent, was it not?

Mr. ECCLES. Well, I do not recall.

Mr. DEWEY. Or 5¼ percent.

Mr. ECCLES. It was an entirely unnecessary rate.

Mr. DEWEY. Well, if I recall, it was around 5¼ percent, and if I further recall, in about 1921 or 1922, despite that rate, those securities fell to a discount of about 15 points, or around 85. So I was wondering, if you found it necessary to do refunding, what interest rate you would have to pay on that refunding, with the securities at a great discount?

Mr. ECCLES. You would not need to have a discount. In the first place, no 5-percent rate was ever justified. During the last war there was a shortage of funds, and all during that period we were tied to a gold standard to such an extent that we let the gold standard determine our ability to finance.

We have learned a good deal since, I think, and had we known anything about open-market operations, and they were unheard of, but if we had known anything about the technique of open-market operations——

Mr. DEWEY. We had war loan accounts, which were practically the same thing.

Mr. ECCLES. But they meant borrowing from the Federal Reserve at the discount rate, which was plenty high.

Mr. DEWEY. But the Federal Reserve fixed it.

Mr. ECCLES. The Federal Reserve System did, yes; but the point that I am making is that if an open-market operation had been carried out at that time, the Reserve System could have bought, just as other central banks in the world had done, securities in the market. They would have increased the reserves of the banking system, which would have kept the rates down. But, when the war was over, there was no support whatever given to the market; as a matter of fact, a restrictive policy was adopted by the Reserve System in order to deflate prices, and it was so announced, and we heard at lot about it ever since. The Reserve System forced a contraction of credit after the war through a monetary policy, which of course could not do other than force a great sale of Government securities.

It was the way that the money system was managed at that time, and it was based upon what was the common conception not only in this country but throughout the world, and with the problem of inflation and deflation, it was increasing or decreasing the supply of money. That was the simple way that they had of doing it, and so the problem in the Government securities market was created by that conception, which in my opinion was an erroneous conception, and a conception that you will never see again.

(At this point there was an informal discussion among the members, off of the record by direction of the acting chairman.)

Mr. CRAWFORD. In your speech before the United States Chamber of Commerce last May you said you did not believe that the Government would be justified in paying more than 2½ percent on long-term obligations even if legislation were passed to reestablish control over excessive reserves. Were you referring to an average 2½-percent yield on the regularly published index of the long-term Treasury bonds?

Mr. ECCLES. No. I was not referring to anything specifically, but speaking in very general terms; and when I referred to a long-term security that, of course, is a relative matter. Some may consider 10 years a long term and others 25 years.

Mr. CRAWFORD. Is there anything in the monetary situation that would cause you to change your views in that respect?

Mr. ECCLES. Nothing whatever.

Mr. CRAWFORD. Would you care to express yourself as to how you would maintain long-term bonds in the market at those levels—in other words, what methods, if any, you would use?

Mr. ECCLES. If the supply of funds already in existence, deposits in the banks, was not sufficient to meet the Government requirements, then I certainly would not want to increase the rates in order to induce further investments, because I feel that 2½ percent, in the absence of other opportunities for investment, and by reason of a large supply of funds, would be an adequate return.

Now, if, then, the Government had to have more funds than came from that source, first it ought to press the tax question further, so that those sources would be sufficient; but, failing to do that, it should then use the short-term market to some extent. If it was unwilling to do that, it could use the open market and the Reserve System through either its open-market operations or through leaving sufficient excess reserves in the picture, which would certainly assure the Treasury of all the funds it needed for the banking system. You have that as a last resort which can be used with the full support and cooperation of the Reserve System and the open-market committee.

So that is the way that you would effectively control the pattern of rates if you agreed to.

Mr. CRAWFORD. Would you say that in that manner you would control the market price—as you might say, peg the market—and, through using these various powers, you would support your market and maintain your rate?

Mr. ECCLES. You would have to protect the market price. As I say, the interest rate and the money market are purely artificial things, not actual things. We might say that we could increase excess reserves further than we are, thus creating a greater abundance of money in relationship to the investment opportunity. Those powers are within the Reserve System, the Treasury, and so on. Likewise, if the Reserve System had power to do so it could diminish the supply of excess funds, and that in turn would affect the rate, so that the rate is a matter of control, and it has been so for a long while.

We talk about the natural market rate. There is no such thing and there has not been such a thing for a long while.

Mr. CRAWFORD. In your necessary close working arrangement with the Treasury, would you care to say whether or not you believe that the securities which you sold to commercial banks, say from now on, should be restricted to short terms, confined to short-term issues?

I bring that up for this reason, that I think I am safe in saying that the Board and the Treasury, based on announcements and statements made by each, are in agreement that the commercial banks should not buy any more of this paper than is absolutely necessary to keep the wheels going, and that we should put as much as possible in the hands of savings institutions and individuals.

Mr. ECCLES. Yes; and all the time that we have been saying that, the banks have been purchasing the entire increase in the Government debt, outside of the savings securities. The banks' holdings, in Government securities, have been about equal to the total increase in the open-market debt.

I would prefer to see any financing that is done by the Treasury in the open market primarily a short-term obligation until such time as it may be possible to determine how much of the financing can be done outside of the banks.

Now, I would not say that indefinitely I favor all open-market operations being in short-term securities. I could not cross that bridge at this time.

Mr. CRAWFORD. I get your idea on that.

Now, referring again to your Fortune article, you point out that the chief effect of the superabundance of excess reserves has been to drive interest rates down to unprecedented low levels. You said that the decline of rates at such extremes tempted the banks to get more and more into loans and investments in order to sustain earnings, and that some increase in short-term rates that would result from reducing excess reserves to manageable proportions would be in the interest of the entire credit system.

Roughly, how much of an increase in short-term rates do you think would result from successive increases in reserve requirements, and how much of an increase do you think would be desirable?

Mr. ECCLES. Of course, that would depend upon the extent to which the excess reserves were reduced. It would likewise depend upon the extent to which private industry's demands were financed by the banks, other than by the R. F. C. or the other agencies of government.

It would be very difficult, it seems to me, to say to what extent the short-term rate might increase until you answer these other questions.

Mr. CRAWFORD. In other words, rate-making is not brought down to such a scientific method that you can yet say, for instance, that if you reduced excess reserves 50 percent, the rate will go up such and such a percent?

Mr. ECCLES. If you are speaking of what we term the money market, there is only one money market; New York is the only money market that you have, and the excess reserves, through the interbank relationship, flow into that market. The rate on Government bills, of course, is very, very low. That is one type of rate. The rate on acceptances is another type. The rate on commercial paper is another.

So that, when you talk of the short-term rate, you have to think of it in terms of the market which you are borrowing in, as well as in terms of the type of paper that you are using, and certainly the short-term rate is so low that banks are unable to live on the income from the short-term rates, and it has forced them more and more into the long-term field, and they have been forced more and more to make commitments on term loans on less and less favorable terms, and at some point, if the thing keeps on, they might get the banking system, or at least a part of it, into some trouble, and every time that they are forced to get credit out, it in itself ends to serve as an inducement for expansion, for purchasing power, and, as I said this morning, it is a passive situation. That is true, and I think that the short rate should be increased to some extent in order to take off some of the pressure, of the banks reaching out to the extent that they are.

Mr. Crawford. Let me ask you this on that point: The British authorities, I believe you said, pay 1½ percent on 6 months' short-time paper.

Mr. Eccles. Yes.

Mr. Crawford. As against that, we are functioning under about what rate?

Mr. Eccles. It is practically an uncoordinated rate on 90-day bills.

Mr. Crawford. Would you go so far as to say——

Mr. Eccles (continuing). Of course, I think that 1½ percent for our situation would be entirely unnecessary.

Mr. Crawford. Would you go so far as to say that in your opinion the British set that rate at 1½ percent ceiling, as you said awhile ago, because that was a rate which they felt was necessary in order to maintain their credit machinery?

Mr. Eccles. That is right, to keep the banks out of the long-term field.

Mr. Crawford. You also made an observation now that in your opinion it is not at all necessary for us to have anything like as high a rate as that to get along with our situation over here.

Mr. Eccles. That is right.

Mr. Crawford. I have one other question, and I do not know but what Mr. Williams covered it, and if he did, let us not take it up again. That question was to inquire of you as to whether or not, in your opinion, installment credit control should crowd out of the field F. H. A. loans on residential property?

Mr. Eccles. He did not ask that question.

Mr. Crawford. What do you think about that?

Mr. Eccles. Of course, it does not in any affect the F. H. A. loans under title II. It only affects the loans under title I. They are subject to the same restrictions of 18 months, that is, under title I, which is the repairing and modernization feature.

Mr. Crawford. And so far you have not touched title II?

Mr. Eccles. We have no power over that. In fact, the regulation specifically excludes housing in total; that is, it specifically excludes a total home. Mr. Henderson and I agreed that it should specifically include it or exclude it and not leave the question open, because the thing was of too great importance, and to have included it, we felt, would have delayed getting out the order and getting the thing into effect in the rest of the field, and therefore we left the home field open, feeling that it was a matter that should be dealt with by an amendment to the order. As I said awhile ago, it was being controlled certainly to some extent by the use of priorities.

Mr. CRAWFORD. Now, with your experience thus far under the Executive order, would you care to state to the committee whether or not in your opinion we should go so far as to include home financing, including all of the F. H. A. operations, and thereby assist priorities, and cut the thing off entirely?

Mr. ECCLES. No; I would not be prepared to say that. I would not think it desirable at this time to do that; and, if so, it should be done after consultation with Mr. Jones and others who are interested in that field of home financing that comes under the Loan Administrator, and I have not discussed that either with the Treasury or with those people, and I would not want to express an opinion, certainly, without the benefit of that consultation.

Mr. CRAWFORD. I have one other question. You referred to the taxing of excess profits. Did you mean to leave the impression, which I got, that the new tax law does not, in your opinion, go far enough?

Mr. ECCLES. That is right. I do not think it does.

Mr. CRAWFORD. I agree with you on that.

Now, you spoke of a tax as low as 75 percent on profits over 15 percent, I believe it was.

Mr. ECCLES. Well, I said that a 75-percent ceiling on profits over some amount, whether it should be eleven, twelve, thirteen, fourteen, or fifteen thousand, would be a question for the consideration of the Congress, and I was not trying to fix any amount. In other words, if we put a 10-percent ceiling as a maximum, and a 5-percent floor, then certainly you should have the 75-percent rate apply when the income above the floor was a certain percentage and when the income above the ceiling was a certain percentage.

Mr. CRAWFORD. But you do feel that 75 percent is as high as we should go?

Mr. ECCLES. 80 percent would be a maximum. In other words, the English have not gone beyond it, and in the last war, after we were already in it, 80 percent was the maximum. If we get over 75 percent at this time as applied to the excess profits we would be pretty high.

Mr. CRAWFORD. Would you be inclined to go along with a 75 or 80 percent, plus a 25 or 20 percent savings on the part of the corporation recaptured by the Government to be turned back at a later date, similar to the British?

Mr. ECCLES. Well, I would not be prepared to say on that. I would want to study it and think about it. There may be a point in the situation where something of that sort may be necessary. But I do not believe that we have reached it yet.

Mr. CRAWFORD. That is all, I think. Thank you very much.

Mr. ECCLES. I was asked this morning, I think by you, Congressman Crawford, to insert in the record certain documents, and I have them here and I will give them to the reporter, to be inserted.

The CHAIRMAN. They will be incorporated in the record.

(The documents referred to are printed below.)

[Reprint from Fortune, August 1941]

PRICE FIXING IS NOT ENOUGH

By MARRINER S. ECCLES, Chairman, Board of Governors, Federal Reserve System

To meet the threat of inflation we need certain direct controls. But there is no substitute for the immediate adoption of hard-boiled fiscal and credit policies.

For 10 years, prior to the start of our defense effort, the country struggled to overcome depression and deflation. Now, almost overnight, we are confronted with the dangers of overexpansion and inflation. Instead of seeking means of adequately using our material and human resources, we are now facing shortages in various important categories, both of men and of materials.

For a decade we have been striving to stimulate consumer demand and purchasing power sufficiently to match our productive capacity. Today our problem is to curb consumer demand and purchasing power so that they will not divert too much of our productive capacity to the manufacture of nonessentials and will not bid up the prices of materials needed for defense as well as of other commodities, while we devote an increasing portion of our productive machine to defense purposes. The country must undergo a rapid readjustment of its thinking in order to comprehend the meaning of shortages rather than surpluses in many fields.

More than that, we must learn that the success of our defense program turns on what we put into it, not on what we can get out of it. As yet, speaking generally, our people are not thinking in terms of defense production and of the sacrifices demanded of all groups. Businessmen are primarily interested in the profits to be made, labor is interested in higher wages, the farmers are concerned with crop prices, the investor is thinking about larger interest returns. These are the preoccupations of peacetime—not wartime. It is no longer a question of what we can get out of defense, but what we can give to it. Today's economic problems are in large part the economics of war, not of peace. They are the opposite of those that beset us for a decade.

Until about a year ago we needed to discourage saving, to encourage expenditure and credit expansion. We needed to reduce interest rates in order to encourage borrowing. We needed to keep taxation down so that the money spent by the Government would be added to the spending stream. To that end some of us urged deficit financing as a deliberate policy. The country pursued fiscal and monetary policies that in general sought to encourage credit expansion. We allowed ourselves to be inundated with high-priced gold as well as silver, which served to swell our bank deposits and excess reserves to unprecedented levels, thereby forcing interest rates to all-time lows.

Throughout the decade, however, we remained in a state of semidepression because we were not willing to have the Government supplement private enterprise with a sufficient amount of activity and expenditure to employ our idle manpower and resources. While we had a degree of recovery, it never carried through to the point of reasonably full employment. At no time had we less than from eight to ten million unemployed. Much was done to encourage housing, to stimulate production of capital goods. States and municipalities were subsidized to a large extent by Federal outlays for public works. We succeeded in bringing the national income up from some $40,000,000,000 at the bottom of the depression to an average of approximately $70,000,000,000 for the end of the decade. We constantly heard prophecies of inflation. But inflation did not materialize because we were never able to take up our industrial slack. And until our real defense effort began a little more than a year ago we were still utilizing not more than 70 percent of our full capacity.

All this is now drastically changing because of huge defense expenditures. We are rapidly moving toward a condition of full use of our physical capacities, though not yet of our total available manpower. Instead of discouraging savings, we need now to encourage them. Instead of encouraging consumer expenditures, we need to apply curbs on private spending wherever it threatens to encroach on defense needs or to distort prices. Instead of stimulating consumption by deficit financing, we need so far as we can to reduce the deficit and to approach a balanced budget as the country reaches a condition of full utilization of its productive capacity. All public authorities, both State and National, should suspend their nonessential public works and other activities that use men or materials needed in defense production. In this way they can build up a backlog of public undertakings that will help to offset a post-defense slump. All public outlays other than those for defense or for maintenance of essential social services including such agricultural benefits as may be necessary to bring about a reasonable balance between agriculture and industry, need now to be pared to the bone. Instead of a tax structure designed to encourage consumption, we need one that will recapture for the Government a large part of the outlays for defense. Interest-rate policy should now be directed toward encouraging savings and investment in government securities for the financing of defense—not to stimulation of private credit expansion.

NOT DOLLARS BUT GOODS

It is a commonplace, which we are prone to forget, that the measure of real wealth production of any country is to be found in the physical goods produced. War and preparation for war force us to turn our eyes away from the dollar sign and to this reality. We cannot defend ourselves or fight with dollars—we need guns, tanks, ships, airplanes, ammunition. Similarly we cannot eat, wear, or live in dollars, which are only useful as they enable us to acquire food, clothes, and shelter. Had we been able to see this clearly in the past decade—had we turned our immense productive machinery to making the things of peace as we are now obliged to use it to produce the things of war—our standard of living would have exceeded anything the world had ever seen. We could have afforded it—indeed, the tragedy of the period is that we thought we could not afford it.

We no longer hear the plaintive question, Can we afford it? for we all know that what we cannot afford is to fail to produce for defense. By the same token, however, when peace comes it is to be hoped that we shall have learned the lesson and that we shall produce for peace just as we must produce for war—up to the limit of our productive capacity. But there will be a great difference. What we produce for peace will make the world a better place to live in. Armaments protect but do not improve our way of life. If we learn to apply the sound economics of the engineer who thinks in terms of the production of tangible things rather than the economics of the financial operator who thinks in terms of dollars, we shall have done as much to preserve democracy for the future as all the armies that could be mobilized.

Despite the fact during the past year we have been engaged in a large-scale, though still not a full, defense effort, we have not so far encroached upon or reduced the standard of living of any group of our population. On the contrary, the standard has steadily increased through the absorption of the unemployed and a rise of income of the employed. Nevertheless we are stepping up our rearmament effort very rapidly, and civilian supply must give way as our defense production increases. During the past fiscal year we expended about $6,000,000,000 for armaments. In the coming fiscal year we may divert anywhere from $12,000,000,000 to $18,000,000,000 to armaments. If we push up our national income to a maximum output of $100,000,000,000 per year without a drastic rise in prices, and expend, say, $20,000,000,000 on armaments, we should have $80,000,000,000 left for other purposes. But it is quite possible that we shall have to divert anywhere from 30 to 40 billion dollars to armaments to catch up with, to say nothing of surpassing, Germany. In which case other needs would have to be rigidly curtailed.

But the problem is not so simple as these figures, used purely as examples, indicate. In many cases defense requirements are already absorbing not just 40 percent of output but, as in the case of aluminum and other strategic materials, 100 percent. On the other hand, there are other categories where rearmament will impinge little if at all. This is particularly true of agricultural production. Hence the problem is not one of allocating a specified percentage of all classes of production between civilian and defense requirements. It is rather a problem of making such allocations as may be necessary in the different fields of activity. At present our problem is not one of guns or butter. In our case it is more nearly a question of guns versus more automobiles, refrigerators, and other durable goods, the purchase of which we must defer at this time in the interests of rearmament. And the extent to which we can avoid sacrifice depends upon our ability to increase production in those fields where the greatest shortages exist.

TWO TYPES OF CONTROL

The fact that we have abundance of some kinds of goods, yet already are meeting drastic shortages in others, greatly affects the kind of policy we should adopt in meeting one of the great economic problems of any war, namely the control of prices. In general, it is well to distinguish between two very different kinds of price distortions that a great rearmament effort or war itself entails. First, there may be selective price distortions brought about as the Government suddenly enters the market for munitions of all kinds. Second, there can be a general price distortion caused by the fact that the Government is pouring out huge sums for rearmament, thus swelling pay rolls and corporate disbursements, while at the same time the production of consumers' goods is being curtailed or only slightly expanded. This general phenomenon, where the active purchasing power in the hands of the public outruns consumer output, is inflation.

It is also essential to distinguish two different ways by which prices can be controlled. One way I should call the direct method where the Government steps in and keeps specific prices from getting out of hand. The other way I should call the functional controls by which the Government seeks to curb the purchasing power in the hands of the public by broad fiscal policy or other means. Now it is perfectly apparent that in that sector of the economy where the Government is a huge purchaser—the portion that might be called the military sector—we must have immediate and direct controls. Priorities, rationing, and specific price fixing are going to be the order of the day here. In the case of aluminum and machine tools, for instance, allocation is made not by a bidding up of prices to determine what buyer shall receive what, but by Government edict. You may offer right now any price you want for a machine tool but it will not help your chances of getting it. It would be folly to leave distribution of any vital war material to the mercies of "the market."

But what of the more general problem of inflation? What of the bidding up in prices of consumers' goods that comes as the public receives increased purchasing power and comes up against a diminishing or static supply? Here too we might try to rely on direct controls, and indeed in some cases will to advantage. We may use a "rifle," not a "shotgun" technique. Nevertheless, the job of trying to control many consumer prices by direct action is more difficult than is often supposed. Who is to set the price of lingerie, and women's stockings, and boys' hats, and golf balls, and a million other items that indirectly affect the cost of living? And how are we going to distribute the products equitably once the price is set? For when you fix a price you are just at the beginning of your troubles. You have taken away from the market its normal function of distribution and there will be more buyers at the fixed price than goods to go around. At the present time we are trying to fix prices on automobiles, and in this case we should do so. But you may have noticed that your auto dealer is having a much bigger say over your life than ever before. He is deciding whether you or the next man shall get the new car. And the only substitute for the dealer would be a Government agent snooping about to do the distributing job.

It is well to remember that this is not a small country like England, where it is fairly easy to enforce Government price edicts. It is not a Germany, where people are used to taking orders about prices and distribution. The fact is that in the civilian sector of the economy we have every reason for dropping back on traditional functional methods of price control, namely, the curbing of consumer demand through taxation and other means. We have every reason; that is, to try to ward off inflation by keeping consumer purchasing power in adjustment with the output of consumers' goods and to avoid more totalitarian methods until absolutely necessary. We have every reason for framing an intelligent fiscal policy.

But I use the word "intelligent" advisedly. I do not hold for taxing all equally. For too long too many of our people have existed on too low a standard of living, in terms of the Nation's capacity to produce. And we are not going to let the war make the situation worse. The basic needs as a matter of health and morale must be met. Low-income groups should not be expected to make sacrifices in food, clothing, and other necessities, for they have had too little. The sacrifices must come from the more fortunate groups, those who can get along with fewer automobiles and other goods needed for defense but not essential for civilian well-being. In other words, restriction of consumer demand should start at the top and work down rather than start at the bottom and work up.

THE CRITICAL TAXES

The power to tax is the most fundamental means of doing this. It is the most effective as well as the most equitable of all the broad functional powers at the command of the Government. The tax system should be designed to recapture for the Government a large part of the defense expenditures and, so far as possible, to reduce consumer demand for goods where the supply is inadequate.

To accomplish this aim we shall have to rely mainly upon four types of taxation: (1) Corporation-income and excess-profits taxes, (2) greatly increased normal and steeply graduated surtaxes on individual incomes, (3) high excise taxes on durable consumers' goods, and (4) inheritance and gift taxes.

During the emergency we shall have to rely heavily upon the excess-profits tax and the tax on corporate incomes. This is true because, generally speaking, business units are the greatest beneficiaries, directly and indirectly, from defense expenditures. The profits accruing from the expanding national income tend to become concentrated here in the first instance. Consequently, one of the surest ways to safeguard against price inflation is for the Government to levy on such profits and divert them directly into the defense program before they are distributed into the general income stream through higher wages and increased dividends.

Perhaps the most compelling reason of all for the imposition of the excess-profits tax is that, if not taken by the Government such profits will lead to further demands for higher wages. If wage increases continue to be freely granted to those who have already received substantial increases, they will swell unduly the volume of private purchasing power. Labor should certainly be willing to moderate its demands for increased wages, but it cannot be expected to follow such a course if employers are permitted to retain excessive profits. Moreover, with increasing personal income taxes, many corporations may be expected to leave a large proportion of their profits undistributed. In the absence of an undistributed-profits tax, therefore, these will be beyond the reach of the Government, unless recovered through heavy taxes on corporations.

The corporate form of ownership is the principal institution through which capitalism functions. Owners and managers of corporations, vitally interested as they are in preserving capitalism, have every reason to favor, not oppose, heavy taxation of their profits, for thereby they will help to protect the country against the inflationary dangers that would undermine the foundations of capitalism. They have the greatest stake in democracy—the most to preserve. They should not expect those who have the smallest stake to pay an unjust share of taxation.

During the emergency the excess-profits tax should in my opinon, be the keystone of a well-balanced program. Increased taxes, however, should not be imposed on the great numbers of small business concerns and on millions of individual taxpayers until they have been given every reasonable assurance that the funds they are being asked to provide will not go to swell the profits of wealthy individuals and corporations.

In addition to heavy taxation on corporations, personal income taxes need to be substantially increased, ultimately to a point far beyond anything now proposed, if inflation is to be avoided. Heretofore they have been exceedingly moderate, as compared with those in other countries, except in the very highest income groups. Now, with expanding employment and pay rolls, it is equitable and necessary that some of the benefits be recovered by the Treasury. Reducing exemptions, thereby broadening the base and increasing the number of income-tax payers, is necessary to help check excessive consumer buying power at this time. Broadening of the income base to include the lower income groups will obviate the need for taxes on the necessities of life. Indiscriminate sales taxes on all purchases are inappropriate and inequitable. Such taxes fall heaviest on those with the least ability to pay—those who spend their entire income on necessities. They are indiscriminate, not selective. They would strike needlessly at consumption of food and other necessities that we can produce without impinging on defense.

On the other hand, heavy excise taxes on consumer durable goods of all kinds that compete with defense are of vital importance. Such taxes are added to the cost of the goods paid by the purchaser. Consequently they diminish the ability to buy and tend to reduce effective demand. Such taxes, applied, for example, to automobiles, are essential primarily as a means of bringing about the necessary diversion of productive facilities to our defense effort.

As for estate and gift taxes, there is little disagreement regarding the underlying purpose of these levies. This purpose is to subject the passage of wealth from generation to generation to an effective system of taxation at graduated rates. The amount of tax should not depend in any significant degree upon the form in which the wealth is transmitted. Existing exemptions should be greatly reduced, the rates increased, and loopholes closed.

BONDS FOR ALL

While taxation is the most important weapon for combating inflationary price rises by drawing off purchasing power, particularly from those areas where shortages exist, the tax structure must be supplemented by other means. Buying power needs to be further dampened by drawing off funds into Government savings bonds and other United States securities. The sale of Government securities to the public, other than commercial banks, will have the same effect on buying power as taxation in absorbing funds that otherwise might go to the market place. Furthermore, purchases of such securities have the advantage of storing up buying power—in effect of deferring demand—until such time as our productive machinery can revert from defense to civilian production. The transition to a more normal peacetime basis can be more readily effected without a postdefense slump if such a storehouse of buying power is increased during this period. Funds then coming on the market can do so without bidding up prices since industry will be able to supply civilian demand when it no longer is heavily concentrated on producing defense materials. It is important that the volume of funds obtained through taxation and borrowing from the public be sufficient to cover all of the Government's outlays during the defense period without resort to borrowings from commercial banks. For the sale of Government securities to the banking system creates new deposits—that is, new money—and the volume of deposits has already reached formidable proportions. Demand deposits and currency outstanding now aggregate about $45,500,000,000 as compared to about $18,500,000,000 in 1918 during our participation in World War I, or about 40 percent as much as we have today. And it should be recalled that the World War I price level was far higher than it is at present, thus requiring much more money to do the same volume of business. The volume of funds already created is more than ample for all present and prospective requirements. It is not necessary or desirable to add new deposits by selling Government securities to the commercial banks. The Treasury, in fact, has declared a definite policy of avoiding this so far as possible.

Accordingly the Treasury has embarked upon a program intended to attract, through borrowings, accumulated and current savings of various groups. There are, broadly, three major categories of savings. One consists of individual, corporate, and trustee funds from small amounts up to $50,000. A second consists of larger corporations, wealthy individuals, trustees, and various public and private bodies that now have or will have unused funds available for short-term investment. A third group is composed of large individual and institutional investors, including insurance companies with funds of more than $50,000, who are interested in long-term investment.

So far as the first group is concerned, the present issues of savings bonds and stamps are well designed, as to rate, maturity, and other terms, to meet the requirements. As for the second category, it embraces funds of the type that frequently are not invested in long-term Government securities and are not attracted by the low rates prevailing on such short-term issues as have been available. It would be desirable, in my judgment, as the Treasury needed the funds, to offer to this group registered short-term issues, possibly of 2-year maturity, paying interest semiannually of from 0.25 to 1 percent, depending upon the length of time held, and redeemable on any interest-payment date on 30 days' notice. Such issues would not be available to commercial banks. Similarly, it would seem to me to be advisable to offer to the third group of the large individual and institutional investors long-term issues of registered securities, bearing interest at 2.5 percent. These issues, likewise, would not be available to commercial banks.

The Treasury has announced available, for issuance August 1, still another important type of issue, consisting of two forms of tax-anticipation notes to meet the requirements of both small and large taxpayers. These issues would serve to draw in funds ahead of tax-payment periods, thus offsetting some of the lag in tax collections and giving the Government the use of the funds while paying interest to the taxpayer, who would be enabled out of current earnings to purchase securities that would be accepted in payment of future taxes.

EXCESS RESERVES

With such a rounded program of offerings available for the various categories of savers and investors, there would be little or no need for new open-market issues that have to be priced at from one to two points above the current market in order to assure the underwriting and distribution, which is done largely by the Government bond dealers and the commercial banks. To the extent that tax revenues are insufficient to cover Government expenditures, the reservoirs of savings can be directly tapped—though, as I have indicated, our reliance should be more and more on taxes as full economic activity is approached so that the Budget deficit may be progressively reduced.

While the policy of tapping existing funds and avoiding creation of new funds in the banking system is in the right direction, the continued existence of the redundant volume of excess reserves remains a constant invitation to the banks to put these idle reserves into Government bonds or to lend them in every other possible way. The chief effect of the superabundance of excess reserves has been to drive interest rates down to unprecedently low levels—short-term rates virtually to zero. The decline of rates to such extremes has tempted the banks into more and more loans and investments in order to sustain earnings. Some increase in short-term rates that would result from reducing excess reserves to manageable proportions would be in the interest of the entire credit system. I believe this could be accomplished without materially affecting long-term rates, which would be likely to remain at relatively low levels because of the abundance of existing funds and absence of private demand in the long-term capital markets.

From the standpoint of Government financing the retention of excess reserves had its own logic so long as the Government was relying on open-market methods for financing the deficit. But, as we have seen, it is now necessary and advisable for the Government to sell its bonds directly to individuals and institutional investors other than commercial banks, and to the extent that it does this the need of excess reserves disappears. Accordingly, a protective measure that needs to be invoked is the granting to the Reserve System of adequate authority to deal with excess reserves when necessary, as a safeguard against inflation.

For clearly, the more bank deposits are expanded on the basis of high reserves, the more difficult becomes the problem of control. During the past year currency and demand deposits in commercial banks have increased by about $7,000,000,000. This has been brought about by a large increase in the purchase of Government securities, by expansion of loans and other investments, as well as by further acquisition of gold and silver. If this trend were permitted to continue indefinitely at this rate, it can readily be seen that the inflationary results would be disastrous. It is futile for the Government to mop up purchasing power through taxation if at the same time an equivalent amount is put into the spending stream through bank-credit expansion. This means closing one door against a danger and leaving another wide open.

CONSUMER CREDIT

The subject of consumer credit is another field of great importance in which restraints need to be applied. As a check to curtail demand for consumer durable goods, selective credit controls may need to be invoked applying to all types of installment credit. It is clear, for instance, that if an individual who pays $500 in taxes and buys $100 of savings bonds is able at the same time to obtain $600 lent on consumer credit his buying power has not been curbed at all.

With national income rapidly expanding, the volume of consumer credit is likewise increasing. Further expansion of installment credit at this time would be an inflationary factor that should be controlled by the banking authorities. The field is now so broad that cooperative action, which has been proposed by various business and credit groups, would be entirely inadequate. Rather, it will be necessary to prescribe standard terms for the purchase of durable goods through regulation backed up by enforcement authority. Such an instrument, while new, has long been needed as a functional control measure since the rapid expansion of installment credit on the upswing and contraction on the downswing have tended in the past to be an unstabilizing influence on the economy.

One of the most important functional mechanisms that should be used as a stabilizing factor on the economy at all times is that of unemployment and old-age pay-roll taxes. This is the time when rates should be substantially increased and made to cover a much larger percentage of the population so that larger benefits may be provided later on when they will be most needed as an offset to a post-defense decline. In a depression these taxes are a drag on recovery, as they were in 1937, 1938, and 1939, because they took much more purchasing power out of pay envelopes than was paid out in benefits. In a defense boom, however, they are ideally adapted, and preferable to enforced savings plans such as have been resorted to in Great Britain, as a means of diminishing buying power.

FISCAL POLICY OR REGULATION

The above measures constitute the basis of a broad, integrated fiscal and credit policy. How much further must we go in the way of direct controls? I believe that that depends to a large extent on how seriously we take the policy as outlined. Certainly some direct controls are needed. Price ceilings have rightly been invoked on various basic commodities on which defense draws most heavily and of which there are actual or prospective shortages. And the fact that a floor has been placed under basic agricultural prices is no reason for not putting a ceiling on them, as well as on other things such as steel and copper, if they push up too far. There must also be restraint on wage increases which tend to start the spiral of wage-price-cost-of-living advances. Hoarding of commodities and speculative inventory accumulations must be dealt with vigorously through inventory surveys and reallocation of critical materials at prices to be determined under Government authority. And broadly speaking, Government action and policy must do away with or diminish so far as possible the incentives to put up prices.

To attempt, however, to impose a general price ceiling covering all transactions and commodities, raw materials as well as finished products and both the wholesale and retail fields, entails infinite complications. Such drastic action constitutes virtual dictatorship over practically all business. Nor is it necessary if a rounded and coordinated program such as I have outlined is followed, if Congress enacts the kind of tax legislation demanded by the times, and the other protective moves are made on all fronts.

It is, as so often in matters of public policy, a question of alternatives. Drastic, unpalatable, as high taxes and other functional mechanisms may be, they are infinitely preferable to the virtual dictatorship of prices, the enforced savings, the ration cards, complicated priorities, and all the other compulsions and interferences necessitated by more direct measures. These are going to be difficult enough to administer in the military sector of the economy, where they are essential to rearmament, without extending them to all consumers' goods.

But one thing is sure. We must prevent inflationary price developments, such as have caused economic havoc in every war and are potentially as destructive as war itself. When we talk of saving our system we mean saving a going concern, an economic system that functions to produce the greatest good for the greatest number. We propose to save it not only from the threat of foreign domination but also from the dangers of internal disintegration through shortsighted policies and half-hearted protective measures. If we will do whatever is needful, even though we may have to abandon for the time being some of our cherished economic freedom, we shall bequeath to posterity a country that is strong and sound, an economic system that has vindicated itself.

THE BUDGET

The estimates of Government receipts and expenditures for fiscal 1942 are Fortune's responsibility. They form an interesting commentary, however, on Governor Eccles' article on the war economy. The distinction between the bookkeeping deficit and the cash deficit of the Government is chiefly accounted for by the fact that net Social Security receipts do not figure in the bookkeeping picture. To the big estimated cash deficit should be added about $1,000,000,000 in the form of net disbursements by various agencies (chiefly the Reconstruction Finance Corporation), not in the Budget. It should be remembered that private-capital investment may be smaller this year, offsetting to some degree the Government's increased net expenditures. Nevertheless a cash deficit of nine to ten billion dollars in a year when rearmament is damping output of consumers' goods is a danger signal.

	Fiscal year 1941	Fiscal year 1942
Bookkeeping basis:		
Expenditures	$12,710,000,000	$22,169,000,000
Receipts:		
From existing taxes	7,607,000,000	9,402,000,000
From probable new taxes		2,200,000,000
Total	7,607,000,000	11,602,000,000
Deficit	5,103,000,000	10,567,000,000
Cash basis:		
Expenditures	13,705,000,000	22,760,000,000
Receipts	9,288,000,000	13,800,000,000
Deficit	4,417,000,000	8,960,000,000

Address at the Twenty-ninth Annual Meeting of the Chamber of Commerce of the United States at Washington, D. C., May 1, 1941

(By Marrier S. Eccles, Chairman of the Board of Governors of the Federal Reserve System)

FINANCIAL PROBLEMS OF DEFENSE

The problem of financing defense is not solely the responsibility of Government. The business interests of the country have a very important role to play. For this reason I appreciate the opportunity, as a public official having some responsibility for the conduct of public affairs, to speak on this subject at this meeting of leading business executives from all parts of the country.

The financial problems of defense arise from the unprecedented size of public expenditures, concentrated mainly in the field of heavy industry, and the necessity for calling forth in the shortest possible time the maximum amount of defense production both for ourselves and for those we wish to aid. The financial problem is not how to provide an adequate supply of money but how to direct the use to which money and credit are put in such a way as to further the success of the enterprise and to avoid inflationary consequences. The avoidance of inflation is as essential for the preservation of our political and economic system as the defense effort itself. I am using the word inflation in the popular sense of disruptive price rises, whether confined to some segments of the economy and due to nonmonetary causes or of a general nature and due to excessive monetary and credit expansion.

We can meet defense needs and supply our civilian population only to the extent that we utilize our man power, materials, and productive facilities. Defense must come first. What is left over will determine the extent to which we can meet civilian requirements. We have no problem insofar as an ample supply of money is concerned. The volume of demand deposits and currency now in existence approximates $45,000,000,000, or 50 percent in excess of the peak amount of the twenties. The present volume could be increased almost indefinitely by further expansion of bank credit in loans to corporations, to individuals, and to the Government. Merely to increase the supply of money would not in itself bring about needed production, but might result in inflationary developments.

Rather, a primary concern of defense financing is to avoid an increase of the means of payment, that is, of money in the hands of those who would spend it faster than our economy could produce goods. This would result in a rapid bidding up of prices. The problem in general terms is simple, but in detailed application it becomes difficult and complex. In general terms, it means that we should aim to finance defense entirely out of taxation and savings, preferably taxation as full employment and production are attained. It means priorities in certain fields where both civilian and defense requirements cannot be immediately supplied out of available raw materials, existing capacity, or available skilled labor supply. It means price controls in cases where demand for essential basic materials exceeds present supply. It means a program of taxation that will transfer back to the Government in the aggregate a substantial portion of the funds spent by Government, thus reducing the funds available to the public for private expenditure. It means encouraging a maximum amount of savings by all groups and classes of the population. It means avoidance of unneeded expansion of bank credit which adds to the supply of money and thus of purchasing power.

It is evident that the general problems of defense financing, which I have enumerated, are interreated and must be dealt with by a coordinated series of measures. For instance, inflation cannot be dealt with solely by monetary and credit measures. As a matter of fact, at this stage of our defense effort such measures are of secondary importance. Fiscal policy, involving both the type of Government financing and taxation, and direct controls are far more important at present.

Let us consider briefly some of the more important aspects of this general summary.

In order to limit the need for price controls and priorities every means possible should be used to increase the output. This can be done by expanding the facilities of production, by increasing the available labor supply where there is a shortage of certain skills, by the working of longer hours, by preventing strikes and unjustified wage and salary increases, and by utilizing to the fullest possible extent existing plant and facilities wherever they may be. To be sure, this is a difficult and a complicated task, requiring full information and full cooperation on the part of Government, industry, and labor.

In my opinion, taxation is the most important single means of maintaining stability in the economy and of preventing either general inflationary or deflationary developments. We must abandon the idea that taxation is merely a means of securing revenue. The effects of taxation on the economy should be the primary consideration. For a tax system to be equitable ability to pay should be the guiding principle. For this reason a general sales tax, which has been strongly advocated by business groups, would be a great mistake, because it would fall heaviest on those least able to pay. Selective sales taxes, which would have the effect of reducing demands for certain products, such as automobiles, mechanical refrigerators, and other articles that use resources greatly needed for defense, are justifiable and necessary at this time. Sales taxes on foodstuffs, clothing, and other necessaries are wholly unwarranted, particularly when surpluses exist. Taxes on such items would tend to diminish consumption, thus reducing effective demand. This, in turn, may create localized unemployment as well as idle capacity that could not be used for defense.

The first source of defense revenue should be the corporation tax and the excess-profits tax, because, in general, corporations are the greatest beneficiaries, directly and indirectly, from defense expenditures. In other words, the surplus accruing from the expanding national income tends to become concentrated in the first instance in the possession of business corporations. The most certain way to insure against inflation is for the Government to levy on these earnings and divert the proceeds directly into the defense program before they are distributed into the general income stream through higher wages and higher dividend payments.

Thus, the most direct way to attack the inflation problem is through heavy corporate income and excess profits taxation. If these surplus funds are not thus collected in the first instance at the source, but are later distributed through large wage increases and large dividend payments to the community, it becomes necessary subsequently for the Government to abstract excess incomes through the personal income tax, excise taxes, and other forms of mass taxation. The problem is not avoided but only delayed and made more difficult by failure to tap the profits at the source.

High taxation of personal incomes and excise taxation will be necessary in any event, but the amount needed from these sources will be reduced by a prior collection at the points where the profits originate, namely, in the business units. If excess profits are not tapped, they will lead to demands for higher wages. Apart from the question of equity and the problem of allaying industrial unrest is the question of going directly to the source of the increased flow of income and diverting it into the defense program before it spreads out into the community and adds private mass purchasing power on top of the Government's demands springing from the defense program.

With greatly increased surtax rates, especially in the middle income brackets, and in the absence of an undistributed profits tax, there will be a tendency on the part of some corporations to hold back disbursements of dividends. This is a further reason for heavy normal and excess-profits taxes on corporations.

In addition, the tax program, to be effective and equitable, should close important loopholes in the gift and inheritance tax laws. Similarly, the setting up by corporations of annuity and pension plans which are charged to expense and provide large benefits to individuals in lieu of increasing salaries and paying bonuses, should not be permitted to become an avenue of tax avoidance.

With reference to the individual income tax, the normal tax and surtaxes on individual incomes have been moderate, compared with other countries, except in the very highest income groups. They can and must be substantially increased. With expanding employment and pay rolls resulting from defense expenditures, it is equitable and necessary that some of the benefits be recovered by the Treasury. Exemptions should be reduced, thereby spreading the base and increasing the number of income taxpayers. This is a more direct and equitable way of raising revenue from the lower income groups than by imposition of certain indirect excise and sales taxes.

To the extent that wages are increased and prices are controlled, corporation profits are less than they would be otherwise, and Federal revenue from this source is accordingly diminished. Under these circumstances, it is only fair that this loss of revenue be made up by taxing directly the beneficiaries of the increased wages.

The tax system should be so designed as to prevent any group from profiting out of this great national emergency at the expense of others. Neither industry nor labor should be permitted to take advantage of the emergency. Men drawn into the Army and Navy are called upon to make great personal sacrifices. Neither unity nor morale can be built upon inequality of treatment of our citizens.

It is a perhaps natural but nonetheless false notion that either capital or labor can make up now for lean years. If they were to reap great profits and higher wages, they would be inviting inflated prices and in the end the added profits and wages would buy fewer goods. I think it is of great importance that we grasp fully the fact that we, as a nation, cannot profit out of world calamity. We cannot turn our industrial machine largely to making the things of war rather than the things of peace and have a higher standard of living.

We have to start from the first principle—and I believe that most of us accept it—that the burdens to be borne and the sacrifices to be made should be equalized as far as possible. And that principle applies particularly to taxation. Therefore, those corporations and individuals who profit most should be the first to be taxed. They must be the primary ones from whom the Government recaptures the proceeds of its expenditures.

I am wholeheartedly in accord with the objectives of taxation policy recently announced by the Secretary of the Treasury when he appeared before the Ways and Means Committee in advocacy of measures to raise an additional three and one-half billion dollars of revenue. As he stated then, the purpose is to design our tax program, first, so that we may pay as we go for a reasonable proportion of our expenditures; secondly, so that all sections of the people shall bear their fair share of the burden; third, so that our resources may be mobilized for defense while reducing the amount of money that the public can spend for comparatively less important things; and finally, so that a general rise in prices may be avoided by keeping the total volume of monetary purchasing power from outrunning production.

The Secretary of the Treasury has proposed that we raise at least two-thirds of the sums necessary for defense out of taxation, and with that purpose I am likewise heartily in accord. The rest should, so far as possible, be raised by the sale of Government securities to the public, thus utilizing existing funds, instead of by the sale of securities to the commercial banks since the latter method creates additional bank deposits. As I have indicated, we need to use existing funds, which are abundant. Expansion of bank credit which creates new funds would only tend toward inflation.

The Treasury's three new types of saving bonds, together with savings stamps, are being offered to the public beginning today. They are excellently designed to give all of our people an opportunity to participate in the financing of the defense program. They are designed to attract the smallest savings of the people as well as those up to $50,000 a year. Apart from that patriotic purpose, however, they are important in helping to protect the country against inflation, and they are a store of buying power for the future when supply can again be matched to demand.

Another very large store of savings which should also be tapped consists of idle balances in banks held by corporations, by wealthy individuals, and by trustees, as well as by various public and private bodies. These funds are frequently not of the type that can or will go into long-term Government securities, nor can they be attracted into short-term Government securities now available, because practically no return can be obtained upon them. I believe many of them would be invested in registered short-term issues (not available to banks) of 2 years' maturity, if such issues were made available at interest payable semiannually, of from ½ to 1 percent, depending upon the length of time they are held, and were redeemable on any interest payment date on 30 days' notice. So far as long-term rates are concerned, I think they are fair and that the Government would not be justified in paying more than 2½ percent for long-term money on fully taxable securities.

To the extent that we pay for defense out of taxes and through borrowing from savers rather than from the commercial banks, thus using existing funds and not creating new funds, we help protect the country against the hazards of monetary and credit inflation. To the extent that people pay taxes or invest in Government bonds, such as the new savings bonds, these funds will not be available for the public to bid up prices in the market place, and they will aid in financing defense, thus avoiding inflationary effects.

This is the time for the public to build up a backlog of future requirements, especially of consumers' durable goods, such as automobiles, housing, etc., that now are using some of the materials needed in defense. Instead of spending existing funds and mortgaging future income for these goods, it would be far better to defer these expediturs until the time when the Government's defense outlays can be reduced. At such a time the backlog of buying power coming into the market will be an offset to the reduced Government expenditures and help to sustain employment and national income.

We should consider the advisability of providing a method of controlling the volume of forward buying on installment credit. Further expansion of installment credit at this time would be an inflationary factor. Installment credit has tended to expand as employment and pay rolls expanded and to contract when both were declining. It has thus tended to be an unstabilizing influence on the economy when it might have been made a stabilizing influence.

I have said that monetary and credit factors are at this time less important than other factors in the situation. Nevertheless, with the existing large volume of deposits and the vast reservoir of excess reserves which could serve as a basis for doubling the existing volume of deposits, it will probably become necessary at some future time to absorb into required reserves a portion of the idle funds held by the banks. This would diminish the pressure on the banks to find outlets for their funds in Government securities and would facilitate the placing of a larger part of the new issues with nonbanking investors. It would also make the banks more careful about avoiding unsound or speculative extensions of credit and would restrain further growth in the already abundant volume of bank deposits. Consequently it would diminish inflationary dangers.

There is one additional matter of importance in connection with defense financing that should be given consideration. It is the subject of public expenditures for purposes other than defense. I do not believe that agricultural benefits should be curtailed, particularly in those fields where agriculture does not profit as other groups do from defense expenditures or is adversely affected as the result of the present international situation; nor do I believe that we should abandon social efforts on the part of the Government in those cases where the problem is not adequately met by the improved employment situation resulting directly or indirectly from defense expenditures.

We are hardly justified in spending billions to aid other countries and billions more in our own defense effort if at the same time we shut our eyes to urgent social needs at home that must depend upon Government assistance. However, reductions should be made wherever this can be brought about through increased efficiency as well as in those fields of Government activity which utilize men or materials needed in private enterprise or in defense.

I have attempted to outline briefly the general public policies which I feel should be pursued to facilitate the financing of defense effectively with a minimum of economic dislocation now and after the defense effort has been completed. The successful carrying out of such a program as I have discussed—and it is a program designed to preserve all of the essentials of our democratic system—depends primarily upon the understanding of and acceptance by the people of this country, particularly the leaders in business and industry.

We have every reason to succeed. We are in a much stronger position than any nation in the world today. We have a vast endowment of natural resources. We have abundant and high-caliber manpower. We have existing and potentially great productive facilities. We can provide, without inflation, all of the monetary and credit resources we require.

We will fail only if we are ignorant of the social and economic problems confronting us or if through blind self-interest we imagine that we can make others bear the sacrifices and burdens which all must share in the greatest undertaking upon which our Nation has ever embarked.

Address at Meeting of National Industrial Conference Board, New York City, Thursday Evening, November 28, 1940

(By Marriner S. Eccles)

In appearing before the National Industrial Conference Board, it is appropriate that I should appraise the national economic outlook as I see it at this time. As Chairman of the Board of Governors of the Federal Reserve System, I am primarily concerned with banking and monetary problems and with fiscal policies as they affect monetary conditions. I can speak only for myself, and not for my associates on the Board or in the Reserve System, or for the Government. Many of the issues which I must touch on in order to present a rounded picture of present and potential problems as I see them are by their nature highly controversial. I wish to indicate my own views as frankly as possible for what they may be worth as a part of the full consideration and discussion that are required by the gravity of the times and the importance of the problems before us.

Underlying my approach to all of these problems is my belief that democracy and the system of free enterprise can function to provide reasonably full and sustained employment for all of our available manpower, in peace as well as in war times. The great bulk of that employment is and must be provided by private enterprise. Public policy, therefore, should be directed to creating an economic climate that will give the greatest possible encouragement to private initiative and private enterprise that is consistent with orderly and continuous national progress.

The experience of the past decade has served to confirm my conviction that having given this encouragement to private activity, Government should assure employment on useful public works, on a basis that is noncompetitive with private industry, for those able and willing workers whom private industry is unable to employ. Far from being wasteful, that is the essence of conservation, for it means adding to the store of national wealth in providing roads, schools, hospitalization, public housing, and other betterments that private enterprise does not and cannot be expected to provide. We gain all these things instead of irreparably losing the product of labor by keeping it idle. Such a policy is economically sound, and when supplemented by an adequate social-security program of pensions, public health, and relief for the unemployables, compensates for the loss of buying power when the expenditures of private enterprise decline. This in turn benefits private business and restores national income and national revenues.

While fundamental principles of Government policy do not change, policies must vary as economic conditions change. Policy that is appropriate to a period of deflation and underemployment is not appropriate for a time of full employment and the inflationary possibilities that then arise. At a time when activity is rapidly expanding and we are approaching conditions of reasonably full employment, the fiscal and monetary policies appropriate to the depression period need to be altered to fit the changed conditions.

A condition of rapidly expanding employment and production has now begun to develop, primarily as the result of our vast defense effort and British purchases and their stimulative effects, both directly and indirectly, on the entire economy. I wish now to discuss what seem to me to be the major factors, in the light of present conditions, that should be taken into account as they affect the banking and monetary field, the Budget, and taxation.

We are again hearing much about the dangers of inflation. It is vitally important to face the inflation issue squarely, but it is also important not to become mere inflation alarmists. We have had too much loose talk about inflation for 7 years. First of all, we must distinguish between a price inflation due to nonmonetary causes and one resulting from monetary causes. I have several times in the past defined the latter as a condition arising when the means of payment in the hands of those who will spend it increases more rapidly than the production of goods. This means that the company has reached the limit of its ability to produce; that is to say, full employment of its manpower and productive facilities, but that, nevertheless, the creation of money continues, uncontrolled and unchecked. A price inflation due to nonmonetary causes arises when production in particular fields is interrupted or curtailed, whether from bottlenecks, shortsighted wage and price policies, monopolistic practices by capital or labor, or related causes, when there is pressing consumer demand for the goods produced in these fields, and when there is neither a shortage of facilities that exist or can be constructed or a shortage of manpower. The cure for such a condition is not less but more production. It cannot be remedied by monetary means, except at the cost of restricting the entire economy.

The immediate danger is that the upward spiral of prices in particular sectors of the economy will throw these sectors out of balance with the rest of the economy, to the detriment especially of agriculture, unorganized labor and both the low-income and fixed-income groups. Since our major objective at all times, and especially when we cannot afford to lose time in building our defenses, is full production and employment, it is essential in the general welfare that business and labor avoid strikes and lock-outs that interrupt the flow of production, and likewise avoid price and wage policies that induce forward buying and inventory bulges due to fears of higher prices.

It would be best for all concerned if through self-discipline capital and labor prevented these abuses from developing, but if they fail to do so, regulation by Government will be necessary. Through increased efficiency and operating for longer hours, capital and labor can increase production. To avoid bottlenecks due to skilled-labor shortages in certain fields, it will be necessary not only to utilize existing skills as fully as possible by working longer hours, but also to increase as rapidly as possible vocational and apprenticeship training. In these ways bottlenecks and unwarranted price rises can be avoided. Otherwise, governments have no choice, as we have seen in other countries, except to intervene directly by enforcing priorities, by preventing strikes and lock-outs, and by fixing prices as well as wages and hours.

These are vital considerations at this time when production must not merely be sustained, but must be greatly expanded to provide defense requirements and at the same time take care of normal civilian needs. I do not think it possible to overemphasize the evils in the kind of inflation originating in what essentially are monopolistic practices either by capital or labor. The result is not only greatly to increase the cost of defense as well as the general cost of living, but the need to redress the unbalanced conditions that inevitably follow calls for increased subsidy payments to agriculture and increased payments in pensions and relief for the aged and the unemployables in order to try to make up for their diminished buying power. Likewise, it leads to demands on the part of all who are employed for increased wages and salaries to help them meet the increased cost of living. The result is the familiar general upward spiral of all prices which in the end benefits nobody, and defeats the essential national purpose of substantially full employment and production for defense as well as for civilian needs.

I am aware that some men in business and in the ranks of labor feel that they should be allowed to make up now for some of the lean years. Past losses cannot be made up now except at the risk of these inflationary consequences. The price and profit increases necessary to make up for such past losses would have to come out of the economy generally, at the expense of all other groups.

This problem—what may be called the bottleneck problem—requires that now more than ever before we keep a discriminating eye on price movements. Any increase in business activity characteristically produces relative scarcities in certain areas of production relative to the whole. These relative scarcities tend to cause price advances This is particularly true of a period dominated by defense expenditures. The defense program is concentrated upon specialized sectors of the heavy-goods industries. Every effort must be made to increase supply in these areas. To the extent that supply cannot be increased with sufficient rapidity to keep pace with both Government and civilian requirements, priorities and rationing may be necessary as a check upon undue price advances.

There would be no economic justice in permitting the necessities of a great national emergency to yield excessive returns to producers in specialized areas at the expense of the rest of the community. Primary responsibility for preventing the break-downs, the price distortions and consequences to the entire economy that would result from the attempt to take advantage of the emergency rests upon business and labor leadership. We need above all in this crucial period rapidly expanding production in the industries where preventable bottlenecks are most likely to develop. The time may come when we shall have to curtail private purchases of automobiles and private and public construction in order to give the defense program the right of way in the heavy industries. But priorities and rationing should not be applied until we have exhausted every effort to enlarge productive capacity in the bottleneck areas.

We must also keep a vigilant eye on speculative forward buying and excessive inventory accumulations. We should be alert to the possibility that the large cash-and-credit resources available might be turned into speculative channels under the favorable expectations which a prolonged defense program creates. We would be better protected against such speculative inflationary developments if the volume of idle funds already existing were curbed and prevented from increasing still more and if our bank credit structure were again brought within range of control.

What I have been discussing are inflationary conditions due to bottlenecks and other nonmonetary causes. Looking beyond these immediate problems, we should be prepared to protect the economy also against the evils of general inflation due to fiscal and monetary factors.

As the result of gold imports, silver purchases, and purchases by banks of United States Government securities the volume of bank deposits has increased to the highest levels in the history of the country. Demand deposits and currency now amount to $41,500,000,000, or about $14,500,000,000 above the peak of the boom period of the 1920's. At the same time, gold and silver purchases have raised the volume of excess reserves to $7,000,000,000, which is a wholly unprecedented volume, capable of supporting a bank credit expansion of fully $60,000,000,000 in addition to the present total of deposits.

As long as these funds have been relatively dormant, they have not presented a serious problem except as they have tended to depress the interest rate structure to excessively low levels. To avoid that extreme—to keep the bank-credit picture within the realm of control; that is the special responsibility of central banking authorities—I advocated, in connection with the Banking Act of 1935, that Congress give the Reserve System adequate powers to absorb the excess, and I subsequently urged that consideration be given to the main causes of this condition, that is, to silver purchases and to the causes of the inflow of gold from abroad which are almost entirely responsible for the present and continuing growth of excess reserves. The authority granted by Congress has been entirely inadequate to cope with the unprecedented growth of excess reserves. For that reason, the Board of Governors as long ago as 1938 recommended in its annual report that Congress take cognizance of and deal with this rapidly enlarging problem.

The need for dealing with it becomes increasingly imperative because of the rapid expansion generated by the defense program. It is essential now that the excess reserves be brought within a range where they can be adjusted to the needs of legitimate business through the open-market function of the Reserve System, and not be left as a basis for an uncontrolled multiple credit expansion such as could be built upon them.

By the open-market function, I mean simply the authority which the Reserve System has to buy or sell Government and certain other securities for its own account, these operations being carried out by the System's open-market committee. The importance of these operations lies in the fact that when securities are bought it increases member bank's reserves. Conversely, when securities are sold from the open-market account it absorbs and thus decreases the reserves of member banks. The open-market instrument is a flexible one, affecting only banks that desire to purchase or sell securities, largely in accordance with their reserve position, whereas raising reserve requirements affects all banks in accordance with their classification. I want to say in passing that, contrary to a persistent popular fallacy, the Reserve System does not use reserves deposited with it by member banks to buy Government securities. Such bank reserves are quite literally locked up by the System and cannot be used as a basis for credit expansion. The System has specific authority to create the funds used in open-market operations. These funds are in no way dependent upon or related to such reserves as member banks carry with the Reserve banks.

Regaining control over excess reserves is a necessary precaution against the inflationary possibilities of overexpansion of bank credit based upon these redundant reserves. It is not a step that would in any way restrict legitimate business expansion, Government financing or development of the defense program. It is a safeguard against necessary expansion delevoping into overexpansion—into creation of the means of payment out of all proper relationship to production. How this tep may best be accomplished is a matter for Congress to determine. However, I see no feasible way to accomplish it except by increasing the reserve requirements of the banks to a point which would reduce the excess reserves to an amount that could be absorbed by the sale of Government securities from the System's portfolio, leaving only enough securities to take care of System expenses. In addition, adequate provision should be made for absorbing future gold or silver acquisitions that add to excess reserves. This power of raising or lowering reserve requirements should be made applicable to New York, the money center, or to all reserve cities, or to country banks, or to any combination of the three groups. This would provide for flexibility and make it possible to adjust reserve requirements more in accordance with needs.

Furthermore, reserve requirements must be made applicable to all banks of deposit, whether they be members of the Federal Reserve System or not. It is not equitable to ask only the member banks of the Reserve System to subject themselves to increases when those who elect to remain outside the System, or those who are now members and who choose to withdraw, can escape sharing in what is a national responsibility. This situation is not only inequitable but it renders monetary control ineffective so long as any bank that does not like the reserve requirements can relieve itself of the restriction by withdrawing from the System. Demand deposits are the major part of our money supply—and control over their expansion and contraction must reach all banks that are in a position to create them.

As long as we have a vast oversupply of excess reserves, the inducement exists throughout the banking system to expand and to put these resources to work in loans and investments. When the economy is reaching the stage of full production and employment that inducement should be removed.

Not only do the excess reserves afford an opportunity for overexpansion but they also tend to depress the interest rate structure to excessively low levels. I have continuously advocated a policy of monetary ease as the appropriate accompaniment of a period of underemployment, but I have never favored artificially low rates such as have been brought about through an uncontrolled surplus of excess reserves. No such oversupply of excess reserves is necessary to carry out a policy of monetary encouragement to business recovery. Instead, excessively low interest rates tend ultimately to induce inflated prices of Governments, municipals, and other high-grade securities. The effects are reflected in credit lines generally, and are felt by insurance companies, savings banks, educational institutions, and other fiduciaries representing the accumulations of many millions of our people, small as well as large savers. Moreover, this creates a future problem for monetary authorities because at such time as it may become necessary to curtail further credit expansion, as a safeguard against inflationary developments, this step cannot be taken without causing a decline in the price of outstanding securities.

Although some interest rates have become extremely low, rates in the home and farm mortgage field have been relatively slow to respond to the general decline and are not now too low, in my judgment. I think there would be no justification for increased rates on home or farm mortgages, and that increases in such rates would be unwise and unwarranted. The volume of existing idle funds is so large that some of the higher bond and mortgage rates may go lower even though there is no further expansion of existing funds.

I am concerned with interest rates not as an end in themselves but as a means to the end of stability in the progress of our economy. Excessively low rates do not contribute to stability any more than do excessively high rates. Neither is fair to lender and to borrower. It is one thing to have interest rates low as the result of the pressure of savings or investment funds on the market. It is a quite different thing to depress the interest-rate structure abnormally through excess reserves created by causes extraneous to our economy. I have always contended, and I reiterate now that these abnormal pressures should be removed, and they must be removed as an essential element of defending the economy against possible inflationary overexpansion later on.

As an additional measure I favor exempting deposits held with the Reserve banks and vault cash held by banks from assessments for Federal deposit insurance. While I have never been against interbank deposits, I do not favor overconcentration of funds that serve no useful purpose at money-market banks, but tend to depress short-term rates to such low levels that the very banks which concentrate their funds in the money centers find themselves in an adverse competitive position. Nor is it to the interest of the money market banks to accumulate excessive correspondent bank balances on which they can earn nothing, but on which they pay the assessment. Furthermore, if a bank's funds are locked up by the authorities to serve as reserves it is not fair to the bank to require it to pay assessments on the locked-up funds that earn nothing for the bank. Another reason for exempting reserves is that there is no risk involved in depositing these funds with Reserve banks and thus no justification for assessing a premium to insure them.

Some of the large city banks have been much interested in getting legislation that will exempt them from paying deposit insurance assessments on the interbank deposits they hold. It seems to me that since they pay no interest to the depositing banks on these funds, that the more equitable amendment would be to exempt the originating bank from paying the assessment if these funds are deposited with Reserve banks. In other words, if any bank is to be benefited by exemption from the assessment, it should be the originating bank which deposits the funds as a reserve in the Reserve System, and not the bank that gets the use of the funds without paying anything for them. It is not in the interest of the city bank to have interbank deposits in abnormal amounts because they cannot be profitably used by reason of their volatile nature. The city banks should be interested in having only such correspondent bank balances as reflect the business done by the correspondent banks and the services rendered for them.

I have dwelt at some length on the general subject, with some of its ramifications, with regard to controlling monetary inflation by controlling excessive bank reserves. This subject, however, cannot be considered separately from the other sources of money creation, that is, Government deficit financing through the banks, and gold and silver policy. As an integral part of the general policy that is necessary for the period we are entering we must discourage the purchase of Government securities by banks. For that creates new deposits. With the volume of bank deposits and currency greatly in excess of the highest levels we have ever had, it becomes important that we do not continue to add to this total, particularly at a time when one effect of the defense program is to activate the existing volume of deposits as they are drawn upon by business and put to more active use. Instead, Government securities should be sold to private and institutional investors. This has the effect of using existing funds rather than creating additional deposits. When the Government borrows existing funds it does not reduce the supply because as soon as these funds are expended by the Government they go right back into the money system again, chiefly as bank deposits. Another popular mistake is to suppose that Government deficit financing creates excess reserves. Instead, they originate from gold, silver, or other currency acquisitions. When the Government sells its securities to the banks, instead of creating excess reserves this absorbs them because the new bank deposits thereby created have to be based upon or charged against the bank reserves.

So long as banks have an oversupply of excess reserves, they have every inducement to invest in Government securities. That inducement can only be reduced or removed by reducing or removing the excess reserves which, as I have sought to indicate, should be adjusted to the normal requirements of business. If this is done the rate on Government bills and short-terms notes would be likely to increase sufficiently to attract the large amounts of idle corporate balances, representing reserves of various kinds, that have accumulated. For the most part, these funds are now deposited in banks and earn nothing for the corporate owners. They would be inclined to invest them in short-term Governments if the yield were raised from the prevailing artificially low levels. At the same time, longer-term issues should be adapted to the requirements of insurance companies, savings banks, and individual or institutional investors. Thus the nonbanking market for Government securities would be broadened out to absorb whatever Government financing may be necessary during the period in which we are making large defense outlays.

But deposits as well as reserves are also increased as gold and silver continue to flow into our money system. Even if we had authority to offset the effect of the gold and silver acquisitions on excess reserves, these acquisitions would still continue to add to deposits, unless we are prepared to deal with these factors at their source. I have publicly stated my opposition to the purchase of foreign silver as unjustified from a monetary standpoint. If, for other reasons, at this time it is considered desirable to assist silver-producing countries, that could be done by making loans secured by silver or other assets. Therefore, Congress should repeal the present legislation, and at the same time cancel out the billion and a half of seigniorage which could be used for issuance of additional silver certificates. Likewise, I favor canceling the authority under the so-called Thomas amendment to issue $3,000,000,000 of greenbacks. Both of these sources of funds, if resorted to, would add to excess reserves and to deposits, and would greatly accentuate the problem of the monetary authorities.

While the expenditure of the gold stabilization fund would have the same effect, the problem of gold presents a particularly difficult question. I believe that Congress, in considering all the interrelated elements of the monetary picture, should consider whether or not it would be wise to make credits available at low rates, as a means of aiding the British, taking as collateral their gold, as well as their security holdings here, in Canada, or elsewhere, rather than to continue to accumulate more and more of the world's gold supply at the cost of inflating our banking and credit structure.

I have come last to the problem of the Budget—but not because it is of least importance. As long as we continue to operate on a deficit basis, it will be necessary for the Government to go to the market for the funds to make up the difference between tax collections and expenditures. I believe that we should at this time take further steps to close the gap between income and outgo as far as can be done without either confiscatory taxation or the retarding of private enterprise. So long as the Government is rapidly increasing its total expenditures, I do not see how these outlays can be covered on a pay-as-you-go basis because the increased national income and the tax revenues resulting therefrom cannot be realized until some time after the sums are spent. In other words, there is a lag between the time when the Government has to raise the money and the time when it takes effect as income among the people who ultimately receive it in payment for goods and services. Taxes on 1940 incomes are paid in the fiscal years 1941 and 1942. There may be a lag of a year or a year and a half before money borrowed for defense, in effect, shows up in expenditures, then in higher national income, and finally in increased tax receipts.

It would not be wise to try to put sufficiently high rates into effect to close the gap entirely until we have reached a condition of full production and employment. But at that time, the tax system in effect should be adequate to bring about the balancing of the Federal Budget.

Revision of the tax structure should not be delayed until a full-employment income is reached. We should begin to redesign the tax system in the near future. First and foremost, we should revise our corporate, individual, and inheritance tax structure so as to close very important existing loopholes that make tax rates much less effective than they should be. For instance, there is not much use in raising individual surtax rates if corporations are permitted to hold back earnings in the form of idle funds instead of paying them out as dividends to stockholders. If the estate and the individual surtaxes are to be made as productive as they should be, then the gift tax must also be revised. The excess-profits tax, which is clearly inadequate, should be revised to apply to all earnings above a certain ceiling, say, of 10 percent of invested capital, with such exceptions as may be necessary as a matter of equity or to stimulate new business. The present law allows an option under which corporations are able to make abnormal earnings after all taxes, including the excess profits tax, are paid— earnings in some cases larger than they have ever been before. I am heartily in accord with the proposals of the Treasury with reference to the excess-profits tax and to eliminate tax-free securities.

The present tax structure, strengthened in the ways I have indicated, will bring in enormous revenues once the national income has risen to ninety to one hundred billion dollars. As national income approaches these levels, rates should be raised still more if necessary to balance the Budget.

In addition to our own large defense expenditures, the amount of which we cannot foresee at this time, there is the increasing amount of help to Great Britain which must also be taken into account. If the total of these reaches a much larger figure than is now apparent, it may be necessary to impose selective consumption taxes on those things that are most essential to defense and the least essential to civilian consumption, in order to divert production and income to defense purposes. This may become necessary as a measure against a general price inflation. But such taxes should not be imposed until we have first placed on the statute books a tax structure sufficiently progressive to insure that the defense program will not increase the current inequality of wealth and income. Indeed, tax policy should be designed to minimize this inequality, bringing about a wider distribution of the benefits as well as the burdens. When full employment and production have been reached, increased consumption taxes are the most effective means of preventing a general price inflation, but they presuppose the prior enactment of steeply progressive income and estate taxes.

Direct responsibility for taxation is, of course, outside the realm of monetary policy, but the subject of taxation cannot be separated from the primary concern of those charged with monetary powers and responsibilities. It is not possible to appraise monetary policy realistically without taking account of the effect of taxation and of Government financing on the banking and credit structure. When the time arrives when monetary restraints may become necessary, deficit financing should be discontinued, thereby bringing the Budget into balance. The time for such action will arrive when the economy has reached full production, that is, substantially full employment, and both monetary and fiscal policy may need to be invoked to maintain a proper relationship between production of goods and creation and use of money.

Since it would be practically impossible to balance the Budget while public expenditures are rapidly increasing and before a much larger national income has been achieved, we might consider viewing certain expenditures for defense as a capital investment. In effect it may be considered a necessary substitute for an equal amount of capital expenditure by private industry which in borrowing for capital outlay would amortize the debt over the life of the investment. If we were to treat the investment in ships, bases, arsenals, factories, powder plants, and the other capital investments paid for by the Government as private business would treat similar capital investment, we might then consider covering only the amortization, operating, and maintenance costs out of current receipts.

No matter how these outlays may be regarded for bookkeeping purposes, the defense program is demonstrating before our very eyes the feasibility of raising the national income through governmental expenditures. Nor can there be any doubt that once a full income is achieved we can, out of a full income, raise enough taxes to cover expenditures. We can then have a balanced Budget.

A full defense effort will bring very large profits. Profits of manufacturing and of trade were already very favorable in the 5-year average 1936–40. Indeed, for a great many companies they were larger than in any previous 5-year period in their history. Many of our industries have learned how to live very well even under quasi-depressed conditions. At a national income level of from ninety to one hundred billion dollars profits can be expected to rise to unprecedented levels. Without a steeply progressive tax structure these profits would bring increased concentration of wealth. Business leadership cannot afford to let the defense program yield this result. We shall do well, therefore, after the tax collection lag of the first years of defense expansion is overcome, to raise the whole of the Budget through taxes.

There is one more suggestion in this field. Some considerable borrowing, in lieu of taxes, from the mass of the population, in the form of a modified "baby" bond, would be highly desirable, especially after a full employment income has been reached. If savings bonds are held widely through the country by the whole population, a degree of security is achieved against unforeseen contingencies. Insofar as such bonds may, after the defense effort is over, be converted into cash and the proceeds spent, business activity would thereby be stimulated just at the time when it needs to be sustained. Such a program would provide in some measure a post-defense cushion against depression. It therefore would seem to me wise, as employment increases and the income of the mass of the population rises, to intensify the national campaign to sell as many savings bonds as possible, especially to the middle-income classes. Such borrowing would not preclude us from balancing the Budget, because we could use the proceeds from the sale of savings bonds to retire a part of the Federal debt now outstanding in the hands of banks and corporations.

Our productive capacity is greater today than ever before. It exceeds by far the peak reached in the boom of the twenties. If we have the will to do it, we have the organization, manpower, and resources to provide both adequate defense and a higher standard of living than any hitherto reached in our history. We are witnessing in the defense program what can be achieved in national prosperity, income, and employment through adequate governmental expenditures. It is my hope that the country will never forget this lesson; that we shall henceforth use fearlessly the resources of the State to help maintain employment and business activity at a full income level. Once such a program is boldly adopted as a permanent policy, businessmen can plan their operations on the expectation of a gradually rising national income. This they have never been able to do in the past. Such a policy, boldly conceived and persistently carried out, would revitalize private enterprise. There is nothing in this program that calls for Government operation of productive processes. All production, even on Government projects, can and should be carried out under private contract. Private business would be assured a full market. The necessary tax bill would be a small price to pay for an assured market adequate to absorb all the productive capacity of modern industry. Think what such a market would mean to business!

After the capital investment in defense is made, we will still have the heavy cost of maintaining our armed forces, which should be met out of current receipts. In addition, it is reasonable to expect at that time there will be large accumulated deficiencies in private construction of all kinds and other capital requirements. But it is unlikely that the volume of private activity would be enough to make up for the deficiency in production and employment once the heavy defense outlays, including the large exports of military supplies to Great Britain, are over. At that time it is of crucial importance that we be prepared to make the transition to a peacetime basis without precipitating a period of idle men, idle factories, declining national income, and increased Federal deficits.

It would be tragically ironic if we, as a nation, solved the problem of unemployment by making instruments of destruction, but were unable to maintain employment by making the things of peace. It is not for the purpose of returning men to the bread lines that we are making this vast defense effort to preserve our political and economic system. The transition will be effected more readily if at that point the Budget is in balance. On the same principle that I stated at the outset, we should then be prepared to have Government take up the slack of employment, employing surplus labor, beyond what private activity absorbs, in useful ways. There are many with which you are familiar, such as public health and hospitalization, and particularly the urgent need for a vast reconstruction and improvement of our entire highway system to keep pace with automotive progress.

There is no excuse for defeatism, for having a static economy frozen at a level of underemployment. We are moving toward relatively full utilization of our men and our machines because of defense needs. When peace is restored to this world, we can, if we have the will and the wisdom, divert such of our productive facilities as are now employed in the destructive work of war into constructive work of peace. Thereby we can lay the foundations for a new and better world—a world in which democratic institutions can survive.

The CHAIRMAN. We will now adjourn until 10 o'clock tomorrow morning; and, Mr. Eccles, we will expect you back in the morning.

(Thereupon, at 5:04 p. m., an adjournment was taken until 10 a. m., Tuesday morning, September 30, 1941.)

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