BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

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STATEMENT OF MARRINER S. ECCLES, CHAIRMAN OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, BEFORE THE BANKING AND CURRENCY COMMITTEE OF THE HOUSE OF REPRESENTATIVES, FEBRUARY 25, 1946, ON EXTENSION OF THE EMERGENCY PRICE CONTROL ACT OF 1942.

This Committee would agree, I think, that inflationary dangers exist when the supply of money in the hands of people who wish to spend it far exceeds the volume of goods and services available. The more this money supply exceeds the volume of goods, the greater the inflationary pressures are certain to be.

It is beyond dispute that the money supply today is at an all time high level, that there is a greater backlog of demand for all kinds of goods than ever before, and that while reconversion has proceeded more rapidly than had been expected, in many important categories goods available to meet domestic, let alone foreign, needs are and will continue for an indefinite time to be far short of demands.

Accordingly, there can be no doubt that the Emergency Price Control Act of 1942 should be extended for a sufficiently long period to enable production to become reasonably correlated with demand.

Price controls, however irksome and difficult to adjust, are virtually our last bulwark against increasing costs of living. This is so because of the extent to which we have removed, reduced or avoided other wartime control mechanisms. We did away with WPB and its allocations of scarce materials and its construction permits. We discarded the War Labor Board and its wage controls. Rationing has been largely abandoned. The excess profits tax has been eliminated altogether and individual income taxes have been reduced. The work week has been sharply cut down. We have avoided adequate measures to curb speculation in capital assets, particularly in the real estate field.

Because we have discarded, diminished or avoided other controls, while incomes have remained very high, it is all the more urgent to retain the Price Control Act until this country's immense capacity to produce, so amazingly demonstrated during the war, brings about an equilibrium between the income and savings which people have to spend and the availability of the goods and services they wish to buy.

What is the money supply today? Measured by demand deposits -- that is, checking accounts -- and currency, the general public (excluding banks, insurance companies, etc., but including Treasury deposits) has available in demand deposits and currency over 125 billion dollars, or more than three times as much as in June of 1940. In addition, the public holds another 100 billions of Government securities -- or eight times as much as in June of 1940 -- and nearly 50 billions of time deposits, or nearly twice as much as in June, 1940. To the extent that dollars borrowed by our people, or foreign owned or borrowed dollars, are added to these resources, the inflation potential will become all the greater. Even allowing for a larger postwar national income, there can be no doubt that on the money supply side of the equation the total today is nearly five times the amount prior to the war and is, at present, vastly in excess of available goods and services.

It is important to understand how such a tremendous increase in the money supply came about because the process should be stopped and, if possible, reversed, now that the war is over. Necessary as it is to retain price and other essential controls for a while and to clear away obstacles, particularly wage and price disputes, that prevent or reduce vitally needed production, these objectives need to be accompanied by an equally strong determination that the Government shall not add further to the money supply.

There is not a sufficiently widespread realization of the fact that our money supply expands through borrowing, whether by private interests or by Government, from the commercial banking system and that, conversely, the money supply contracts when bank loans are paid off or their Government bond holdings are reduced. To the extent that we failed to cover the costs of the war by taxation or by borrowing from the general public, we relied on the banking system to furnish the money. Thus, between June 30, 1940, on the eve of our defense program, and the end of 1945, the Government raised over 380 billion dollars. Of this, 153 billions came from taxes, or only 40 per cent; 228 billions, or 60 per cent, came from borrowing, and of this, 133 billions, or about 60 per cent, came from selling Government securities to others than commercial banks and Federal Reserve Banks, while 95 billions, or 40 per cent, was raised by selling Government securities to the commercial banking system, a process which created an equivalent amount of new money.

This tremendous expansion of bank credit, which has so greatly swollen our money supply, is a primary source of inflationary pressures at this time and will continue to be until goods and services are available in sufficient quantity to balance more evenly the factors of supply and demand.

It is evident, therefore, that on the money side of the inflation problem, the Government should stop and, if possible, reverse the process whereby it creates bank credit. It can <u>stop</u> further creation of bank credit by bringing about a balanced budget. It could <u>reduce</u> the existing money supply in two ways. One would be by paying down the public debt. The other would be by having the commercial banks sell some of their Government securities to nonbank investors. Since this should be accomplished without any increase in interest rates which would, in turn, increase the costs of carrying the Federal debt, it would be desirable to have the commercial banks sell some of their longer term holdings to nonbank investors and to have commercial bank holdings more concentrated in shorter term securities bearing a lower rate of interest.

Stopping further monetization of the public debt in the banking system will tend also to stabilize interest rates so that they will reflect the volume of savings and investment funds in relation to demand instead of reflecting an increasing volume of bank credit. This, in turn, will help to reduce the inflationary effect that a combination of increasing bank credit and decreasing interest rates has on all capital assets.

Policies dealing with the money side of the inflation equation need to be accompanied by wage and price policies on the other side of the equation that will make for rapid achievement of a high level of production on a permanently sustainable basis. Wage increases can only be justified when they can be met out of increased productivity and profits without increasing prices. Clearly, wage increases that result in price increases to the consumer are inflationary.

It has been contended that all price controls should be removed now in order to insure full production. Where price ceilings do not in fact afford a sufficient margin of profit to call forth production, they can and doubtless will be adjusted, but these instances are not general. To argue against all price controls is like arguing against vaccination on the ground that it is better to contract smallpox in the hope that you may recover from the disease than it is to take necessary precautions against contracting it while efforts are being made to eradicate the sources of the infection.

To the extent that we can deal effectively with the money supply and production factors, we will be getting at the root causes of the inflationary problems confronting the country today. Price controls, rationing, curbs on consumer credit or on stock market credit, and similar devices admittedly deal only with effects, not with basic causes of inflationary pressures.

In brief, prudent policy at this time calls for measures to get at the fundamental inflationary causes by curbing or reducing the money supply on the one hand, and by increasing available goods and services on the other hand, and meanwhile retaining price controls, reinforced where necessary by other restraints, until the factors of demand and supply can be brought into a better balanced relationship.

Unless we pursue such a policy, we run immeasurable risks in view of the inflation potential today. If we were to permit a sharp rise in prices to occur, the holders of liquid assets might lose faith in the purchasing power of their holdings. The consequences could be disastrous.