ANTI-INFLATION PROGRAM AS RECOMMENDED IN THE PRESIDENT'S MESSAGE OF NOVEMBER 17, 1947

WEDNESDAY, DECEMBER 10, 1947

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON THE ECONOMIC REPORT,
Washington, D. C.

The committee met at 10:15 a. m., pursuant to adjournment, in room 318, Senate Office Building, Senator Arthur V. Watkins, presiding.

Present: Senators Taft (chairman), Watkins, O'Mahoney, and Flanders.

Also present: Senators Ecton and Kem, and Representatives Horan and Poulson.

Aso present: Charles O. Hardy, staff director; Fred E. Berquist, assistant staff director; and John W. Lehman, clerk.

Senator WATKINS. The committee will resume its session.

I am informed that Senator Taft is unable to be here at the beginning of this session, and asked Senator Flanders to preside. Senator Flanders found that he had to attend another committee, and he asked me to take over for the time being. The members of the committee will come in, and I think, Senator Taft will be here in a few minutes.

Mr. Eccles, I understand, has to leave about 12, so I think we had better start now so that at least the formal matters will be presented.

Mr. Eccles, do you have a statement which you wish to be incorporated in the record?

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

Mr. ECCLES. I have a statement I would like to incorporate in the record. I will read the statement. It is a statement covering a conversation that I had last evening with Secretary Snyder.

In view of the fact that some of the press has emphasized a difference in viewpoint between Secretary Snyder and myself in regard to the Board's so-called special reserve proposal, I would like to take this opportunity to clarify the record.

I have discussed the matter with the Secretary. The fact is that the area of agreement between us is much more complete than has been represented.

Such difference as exists is in evaluating the degree of restraint on inflationary expansion of bank credit that would be exerted by the special reserve requirement. He has expressed to this committee some doubt as to its effectiveness. I am more sanguine about it.

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We both feel that whether the special reserve is needed at all depends on factors which cannot be determined in advance with certainty at this time. We are in full agreement:

One, that the most effective anti-inflationary measure has been and should continue to be a vigorous fiscal program to insure the largest possible budgetary surplus consistent with the Government's obligations at home and abroad.

Second, that coupled with an intensified savings-bond campaign, the program accomplishes two vital purposes. To the extent that savings of the public are invested in savings bonds, spendable funds are taken out of the market place at this time of excessive demand and insufficient supply, and can be used to pay off maturing debt held by the banking system. Likewise, a budgetary surplus can be used to reduce bank-held debt. Both measures reverse the process by which the money supply was increased during the war and are effective anti-inflationary influences.

Third, that the program which the Treasury and the Open Market Committee have been pursuing during the year has been effective and will continue to exert restraint during the next few months, when the Treasury will continue to have a substantial cash balance that can be used to reduce bank-held public debt.

Fourth, that some additional restraint may be expected as a result of the joint statement of Federal and State bank supervisory authorities cautioning banks against overextension and inflationary lending.

Fifth, that the problem will present a different phase when current debt-payment operations are no longer available. If it appears that other restrictive steps are needed, increased reserve requirements or possibly some stronger measure may be necessary.

Sixth, that this will depend on the course of events and, in part, upon self-imposed restraint by the banking community, which has gained a broader understanding of the problem as a result of discussions before Congress and in the press.

Seventh, that the Board's proposal is not in any sense a substitute for, but a supplement to, the fiscal program and direct action on other fronts where inflationary forces are generated but cannot be corrected by monetary and fiscal policy alone.

Eighth, that under present and prospective conditions it is essential to maintain the established 2½-percent rate on long-term marketable Government securities.

Ninth, that restraints should be reinstated or reimposed on installment credit.

The area of disagreement, therefore, narrows down to whether the special reserve would be appropriate if additional measures prove necessary to limit the now unrestricted access of the banking system to reserves upon which a multiple expansion of bank credit can be built.

I am putting that in the record with the knowledge of the Secretary.

Senator WATKINS. In other words, these nine points are the areas in which you do agree.

Mr. ECCLES. That is right.

Since I have appeared before this committee—I think it was on the 25th of November—I have appeared before the Banking and Currency Committees of the House and Senate, and others have appeared before this committee, and before the Banking and Currency Committees

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of the House and Senate in opposition to the reserve proposal that was part of the statement that I made before this committee, and I would like to put into the record a statement which has been hurriedly prepared, but which I believe answers considerable of the opposition that has been raised, if I may read that statement.

There will be mimeographed copies of it available in a short time. It was only finished this morning, and so I am sorry that I do not have mimeographed copies to distribute at this time.

May I read this, Senator?

Senator WATKINS. I understand that it is in answer to the criticisms about the special reserve.

Mr. ECCLES. Yes. I would say it tends to answer the criticisms in general terms, and it possibly further explains some of the aspects of the problem that has been developed as a result of the criticism.

Senator WATKINS. Do you have in mind the testimony given this committee by Mr. Brown yesterday?

Mr. ECCLES. Mr. Brown has been before this committee, and also the Banking and Currency Committee of the Senate. His testimony was a good deal the same on both days. That is one of the criticisms, and there has been considerable in the press also.

Senator WATKINS. The committee will appreciate having your statement, Mr. Eccles.

Mr. ECCLES. I appreciate the opportunity to discuss further the problem of what might be done in a monetary credit field to deal with inflationary forces.

Since my previous appearance before this committee, there has been considerable discussion of the Reserve Board's proposal for a temporary special reserve requirement. There is a good deal of misapprehension and misunderstanding about it.

I should like, as briefly as possible, to put it in what appears to me to be the correct perspective.

In my initial testimony before this committee, I explicitly stated, and I want to reemphasize, that the proposed special reserve is only a part, though a necessary part, of any effective anti-inflation program, and that the need for this authority would be less to the extent that appropriate action is taken on other fronts.

By far the most important action is a continuing vigorous fiscal policy. Because of that policy, there is likely to be little need for the special reserve requirement during the next 4 months. In that period Treasury surplus funds taken from the market through taxes will be available to retire a substantial amount of bank-held debt.

In other words, it looks as though there will be at least seven billion of funds taken out through taxes in excess of what the Government will expend during the next 3 to 4 months; so that, in order to meet those tax withdrawals, the banks will have to sell, be under pressure continually to meet those withdrawals, and will have to sell their Government securities, some of them, or borrow from the Federal or collect loans. But with the large amount of governments they hold, they would naturally sell some of the governments.

Senator WATKINS. It would be short-term governments?

Mr. ECCLES. Not necessarily. I mean, they may choose to sell the longer term. In any case, the Federal Reserve will be the major buyer of those securities. The Federal Reserve is the residual market for them, and so, with the Federal Reserve owning the securities, the

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funds collected in taxes would then be used to retire an equal amount or a like amount of Government debt. That is about the process of it, and, as I say, it will put pressure during the period in the market—that is the point I make here.

However, after this period, we may be exposed to an unbridled expansion of bank credit because the Reserve System's existing powers in the face of its newly acquired responsibilities for the government security market, and in the face of a continued inflow of gold, are insufficient to restrain further bank credit expansion. Considered in this light, our proposal is a precautionary measure to guard against possible disaster later.

Bankers, and certainly the Federal Reserve people, are agreed that the government bond market must be supported and stabilized. Certainly, the Treasury likewise agrees to that.

There is also agreement that the present program of the Federal Open Market Committee and the Treasury should be vigorously prosecuted.

There is agreement that the supervisory policy and moral suasion on the bankers to avoid loans for nonproductive purposes should be agressively pursued.

There is agreement on fiscal policy and the need for maintaining large surpluses in the Treasury cash budget, as much as possible in order to pay off bank-held debt.

There is agreement as to the need of strengthening the savings bonds program.

These are important areas of agreement, and they ought to be kept in the foreground of any further discussions of the use of monetary and credit policy as a brake upon further inflation. At the same time we should not fail to keep in mind the fundamental issue: bank credit is still expanding mainly because of loans. Gold is flowing into the country; the money supply is still growing; inflation is continuing. The question is, What is the next step, if any is required, in doing something about it?

Banking leaders who have already had some opportunity to study the proposed special reserve plan, and have arrived at opinions adverse to its adoption, voice this opposition along two lines of argument: On the one hand, they contend that the plan is impractical, socialistic, and unnecessarily drastic. On the other, they assert that the plan is not strong enough to accomplish its expressed objective. The contrast between these two lines of argument is striking. Both cannot be correct.

First, does the proposal mean regimentation of the banks? Will it unduly interfere with the operation of their business? Will it be a step toward socialization?

In the Board's judgment, the type of authority proposed is neither novel nor revolutionary. The authority provided by the Banking Act of 1935 to raise reserve requirements of member banks to twice the then prevailing statutory level was similar; except for a small margin applicable to New York and Chicago banks, this authority to increase member-bank required reserves has already been exhausted.

In late December 1940, the Reserve Board, the 12 presidents of the Federal Reserve banks, and the 12 members of the Federal Advisory Council unanimously joined in a special report to the Congress pointing out the inflationary dangers for the national economy inherent in the defense effort.

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The special report, recognizing that the authority of the Federal Reserve System was wholly inadequate to deal with the potential excess reserve problem of the banks, recommended that Congress, and I quote:

(*a*) Increase the statutory reserve requirements for demand deposits in banks in central Reserve cities to 26 percent; demand deposits in banks in Reserve cities to 20 percent; for demand deposits in country banks to 14 percent; and for time deposits in all banks to 6 percent.

That is statutory. Today it is half that, and we have the right to double the statutory. Now, the recommendation was to increase the statutory to 26 percent.

For demand deposits in banks in Reserve cities to 20 percent; for demand deposits in country banks to 14 percent; and for time deposits in all banks to 6 percent.

(*b*) Empower the Federal Open Market Committee to make further increases of reserve requirements sufficient to absorb excess reserves, subject to the limitation that reserve requirements shall not be increased to more than double the respective percentages specified in paragraph (*a*).

That would mean 52 percent New York, 40 percent in the Reserve cities, and 28 percent in the country banks.

(*c*) Authorize the Federal Open Market Committee to change Reserve requirements for central Reserve city banks, or for Reserve city banks, or for country banks, or for any combination of these three classes.

(*d*) Make Reserve requirements applicable to all banks receiving demand deposits regardless of whether or not they are members of the Federal Reserve System.

In addition to these major recommendations, the special report urged that the defense program be financed as far as possible from existing deposits and from tax revenues rather than from inflationary borrowing from the banks.

I submit for the record a copy of this special report, because it called for far more onerous and drastic powers than the special Reserve plan, we submit, now calls for.

Senator WATKINS. What year was that?

Mr. ECCLES. 1940.

Senator WATKINS. The report will be made a part of the record.

(The report referred to follows:)

SPECIAL REPORT TO THE CONGRESS BY THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, THE PRESIDENTS OF THE FEDERAL RESERVE BANKS, AND THE FEDERAL ADVISORY COUNCIL

(Reprinted from Federal Reserve Bulletin for January 1941. Issued by the Board of Governors of the Federal Reserve System at Washington)

(Submitted to the President of the Senate and the Speaker of the House of Representatives, December 31, 1940)

For the first time since the creation of the Federal Reserve System, the Board of Governors, the Presidents of the twelve Federal Reserve Banks, and the members of the Federal Advisory Council representing the twelve Federal Reserve Districts present a joint report to the Congress.

This step is taken in order to draw attention to the need of proper preparedness in our monetary organization at a time when the country is engaged in a great defense program that requires the coordinated effort of the entire Nation. Defense is not exclusively a military undertaking, but involves economic and financial effectiveness as well. The volume of physical production is now greater than ever before and under the stimulus of the defense program is certain to rise to still higher levels. Vast expenditures of the military program and their financing create additional problems in the monetary field which make it necessary to

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review our existing monetary machinery and to place ourselves in a position to take measures, when necessary, to forestall the development of inflationary tendencies attributable to defects in the machinery of credit control. These tendencies, if unchecked, would produce a rise of prices, would retard the national effort for defense and greatly increase its cost, and would aggravate the situation which may result when the needs of defense, now a stimulus, later absorb less of our economic productivity. While inflation cannot be controlled by monetary measures alone, the present extraordinary situation demands that adequate means be provided to combat the dangers of overexpansion of bank credit due to monetary causes.

The volume of demand deposits and currency is fifty percent greater than in any other period in our history. Excess reserves are huge and are increasing. They provide a base for more than doubling the existing supply of bank credit. Since the early part of 1934 fourteen billion dollars of gold, the principal cause of excess reserves, has flowed into the country, and the stream of incoming gold is continuing. The necessarily large defense program of the Government will have still further expansive effects. Government securities have become the chief asset of the banking system, and purchases by banks have created additional deposits. Because of the excess reserves, interest rates have fallen to unprecedently low levels. Some of them are well below the reasonable requirements of an easy money policy, and are raising serious, long-term problems for the future well-being of our charitable and educational institutions, for the holders of insurance policies and savings bank accounts, and for the national economy as a whole.

The Federal Reserve System finds itself in the position of being unable effectively to discharge all of its responsibilities. While the Congress has not deprived the System of responsibilities or of powers, but in fact has granted it new powers nevertheless, due to extraordinary world conditions, its authority is now inadequate to cope with the present and potential excess reserve problem. The Federal Reserve System, therefore, submits for the consideration of the Congress the following five-point program:

1. Congress should provide means for absorbing a large part of existing excess reserves, which amount to seven billion dollars, as well as such additions to these reserves as may occur. Specifically, it is recommended that Congress—

(a) Increase the statutory reserve requirements for demand deposits in banks in central reserve cities to 26%; for demand deposits in banks in reserve cities to 20%; for demand deposits in country banks to 14%; and for time deposits in all banks to 6%.

(b) Empower the Federal Open Market Committee to make further increases of reserve requirements sufficient to absorb excess reserves, subject to the limitation that reserve requirements shall not be increased to more than double the respective percentages specified in paragraph (a).

(The power to change reserve requirements, now vested in the Board of Governors, and the control of open-market operations, now vested in the Federal Open Market Committee, should be placed in the same body.)

(c) Authorize the Federal Open Market Committee to change reserve requirements for central reserve city banks, or for reserve city banks, or for country banks, or for any combination of these three classes.

(d) Make reserve requirements applicable to all banks receiving demand deposits regardless of whether or not they are members of the Federal Reserve System.

(e) Exempt reserves required under paragraphs (a), (b), and (d) from the assessments of the Federal Deposit Insurance Corporation.

2. Various sources of potential increases in excess reserves should be removed. These include the power to issue three billions of greenbacks; further monetization of foreign silver; the power to issue silver certificates against the seigniorage, now amounting to one and a half billion dollars on previous purchases of silver. In view of the completely changed international situation during the past year, the power further to devalue the dollar in terms of gold is no longer necessary or desirable and should be permitted to lapse. If it should be necessary to use the stabilization fund in any manner which would affect excess reserves of banks of this country, it would be advisable if it were done only after consultation with the Federal Open Market Committee, whose responsibility it would be to fix reserve requirements.

3. Without interfering with any assistance that this Government may wish to extend to friendly nations, means should be found to prevent further growth in excess reserves and in deposits arising from future gold acquisitions. Such acquisitions should be insulated from the credit system and, once insulated, it

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would be advisable if they were not restored to the credit system except after consultation with the Federal Open Market Committee.

4. The financing of both the ordinary requirements of Government and the extraordinary needs of the defense program should be accomplished by drawing upon the existing large volume of deposits rather than by creating additional deposits through bank purchases of Government securities. We are in accord with the view that the general debt limit should be raised; that the special limitations on defense financing should be removed; and that the Treasury should be authorized to issue any type of securities (including fully taxable securities) which would be especially suitable for investors other than commercial banks. This is clearly desirable for monetary as well as fiscal reasons.

5. As the national income increases a larger and larger portion of the defense expenses should be met by tax revenues rather than by borrowing. Whatever the point may be at which the budget should be balanced, there cannot be any question that whenever the country approaches a condition of full utilization of its economic capacity, with appropriate consideration of both employment and production, the budget should be balanced. This will be essential if monetary responsibility is to be discharged effectively.

In making these five recommendations, the Federal Reserve System has addressed itself primarily to the monetary aspects of the situation. These monetary measures are necessary, but there are protective steps, equally or more important, that should be taken in other fields, such as prevention of industrial and labor bottlenecks, and pursuance of a tax policy appropriate to the defense program and to our monetary and fiscal needs.

It is vital to the success of these measures that there be unity of policy and full coordination of action by the various governmental bodies. A monetary system divided against itself cannot stand securely. In the period that lies ahead a secure monetary system is essential to the success of the defense program and constitutes an indispensable bulwark of the Nation.

Mr. ECCLES. When you do not have immediate use for powers it is very often the situation that there is no hesitancy in giving them to you. It is like the authority given to the Board to impose margin requirements on listed credit extended on listed stocks.

At the bottom of the depression, when there was no market, and remembering the 1929 credit expansion and the crash, there was a great demand that that not happen again, and authority was given to the Federal Reserve Board to impose margin requirements on loans for purchasing or carrying listed securities. For years they were used only moderately. But it is fortunate that they did exist, because they have been in effect now from 75 to 100 percent margin for a considerable time, and as a result, there has been no expansion of credit in that particular field. It is the one field where there has been no credit inflation. Had we gone before the Congress at this time or a year ago or 2 years ago to get that authority, I am perfectly sure there would have been no more chance of getting them than there now appears to get any power to deal with this reserve situation.

Senator WATKINS. You are not very optimistic, I take it?

Mr. ECCLES. No; I was not very optimistic when it was proposed. I have been over here in Washington too long.

Senator WATKINS. What would you do if they were given to you very much to your surprise?

Mr. ECCLES. What is that?

Senator WATKINS. What would you do with those powers if they were given to you?

Mr. ECCLES. If it were unnecessary, as I have indicated that it may well be, that by persuasion the banks might not expand further, by the next few months the budgetary program may be strong enough to hold it in line; but if public expenses are still maintained, and taxes are reduced, and the budgetary surplus is greatly decreased

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or should disappear, you have eliminated one of the most important anti-inflationary restraints that there is, and some of the additional authority may be very much more needed than it is at the moment.

Senator WATKINS. I thought maybe you had in mind Theodore Roosevelt's policy of "speak softly but carry a big stick."

Mr. ECCLES. Well, I think events have indicated that a special authority, or what some people have described as a shotgun back of the door, often serves a useful purpose, although it is often not necessary to use it.

I agree with Mr. Brown, however, that if the authority existed, the effect of its being on the statute books would be to restrain banks, even without putting it into effect; and banks, as they came into possession of excess reserves, would use those funds to buy short-term governments or to hold their funds idle so as to be prepared to meet an increase in a special reserve, should one be imposed. That seems to be one of the virtues of the special reserve plan. The banks likewise would be more careful in shifting from short-term to intermediate and longer bonds. They would, no doubt, have a tendency to reverse that process, and they would also, I think, be likely to be more careful and restrictive in holding down their total loans and in making investments than in non-Government securities. In short, I think the special reserve plan would have some effect, even without its actual use.

The special reserve plan is identical in purpose with an outright increase in regular reserve requirements. The plan, in fact, is no more than an adaptation of this familiar method of dealing with the volume of bank credit. The plan now proposed by the Board would enable the banks to retain the same volume of earning assets they now have, in place of making them reduce earning assets, as would an increase in regular reserve requirements, with adverse effects upon bank earnings.

Is the Board's proposal unnecessarily drastic? In pointing out the inflationary dangers that exist when the supply of money in the hands of people who seek to spend it greatly exceeds the volume of goods and services available, the Board, in its annual report for 1945, indicated that there were three alternative methods for dealing with the monetary aspect of the postwar inflationary problem: First, a limitation on the Government bond holdings of banks. Second, an increase in their regular reserve requirements; and third, the holding of short-term Government securities or cash under a special reserve requirement. Our study of the problem led us to select the special reserve method as the least onerous, the most equitable, and the most practical method.

These specifications for the proposal call for the immobilization, even at a maximum of only a part of the existing large holdings of commercial banks of Government securities. About one-third or more of the $70,000,000,000 of the Government securities held by the bank could be immobilized, if the entire authority were used. The special reserve would be imposed only gradually, and if inflationary bank credit expansion could be otherwise brought under check, the requirement would not be imposed at all.

Under the plan suggested, the individual banker would be left in the same competitive position he is in today. Contrary to what has been stated by a recent national city bank letter, among others, banks would not be under legal or any other compulsion to buy Government bonds. The holding of Government securities in lieu of cash or balances with

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other banks to meet the special reserve requirement would be entirely optional with the individual banks.

The special reserve plan is a middle-of-the-road proposal for helping to deal with the credit and monetary aspects of a difficult and complex inflationary situation. The Board feels, however, that the purpose of restraining further inflationary expansion of bank credit can be adequately accomplished by the specifications it has drawn for the plan, if its use is accompanied by appropriate fiscal and other policies. It would seem that bankers would prefer this proposal to an increase in regular reserve requirements which they recommended in 1940, in anticipation of inflationary developments.

Are existing powers adequate? The argument that the Board's proposal is unnecessarily drastic implies that the suggested special reserve requirement is not needed because the System's existing powers are adequate to restrain credit expansion if the System would use them.

Existing powers are being, and will continue to be, used to the fullest extent, consistent with maintaining the market for Government securities. Under present conditions, however, any further absorption of bank reserves is entirely dependent upon a continued surplus in the Federal budget that can be used to retire public debt held by the banks. There will be little or no surplus in 1948, after March.

You see, even though there is a substantial budgetary surplus for the year as a whole, it comes very largely in the first part of the year, because at that time the tax collections are far greater than any other quarter. Any subsequent surplus will depend upon appropriations and tax legislation yet to be adopted.

Sales of the large volume, of some of the large volume, of Government securities held by the Federal Reserve System would, of course, absorb bank reserves; but such sales, particularly when banks are selling securities to us to expand their credit and to meet withdrawals for taxation, would demoralize the market and cause a sharp break in Government security prices.

The discount rate should be kept high enough to discourage borrowing from the Federal Reserve banks.

Senator WATKINS. Is that not high enough now?

Mr. ECCLES. What is that?

Senator WATKINS. Is that not high enough now to do that?

Mr. ECCLES. It has no effect; and what I wanted to say is the discount rate should be kept high enough to discourage borrowing from Federal Reserve banks, but its effectiveness is limited as long as banks can obtain reserves by selling short-term Government securities. In other words, it might be expressed better than it is.

I should say the discount rate under the present situation is ineffective. The banks, holding the large amount of securities they do, are not going to hold a one-percent certificate or a one-and-an-eighth-percent certificate and a Treasury bill that yields slightly less than one percent and borrow from a Reserve bank if the discount rate is substantially more than that.

Senator WATKINS. The rate is now 1 percent, as I recall it.

Mr. ECCLES. That is right.

Senator WATKINS. You still have power to increase it how much?

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Mr. ECCLES. We can increase it to any amount we want. I mean there is no limit, but it would be completely meaningless; it would be academic, except psychologically; it would be academic because the banks would just not borrow. It would restrict them because they have access to Federal Reserve credit to us in the same manner they would if they borrowed from us through selling governments, and they do not want to show borrowing anyway. They are not going to borrow at a higher rate than the Government securities yield.

Senator WATKINS. I think, as Mr. Brown told us yesterday, they still have plenty of money in reserves of their own.

Mr. ECCLES. The banks have no excess reserves.

Senator WATKINS. None?

Mr. ECCLES. Practically none; they have not kept them for years. If banks get reserves, they immediately press to make loans or to buy governments. I mean, the banks have had no excess reserves for years, because with the coming of the war, and the large amount of Government financing, they invested in governments, and in loans, what otherwise would have been excess reserves, so that there is no prospect that the banks have any excess reserves.

Senator WATKINS. He must have had in mind these governments that they held.

Mr. ECCLES. The governments are the equivalent of excess reserves. I mean, they are equivalent in the sense that what would have been the excess reserves prior to the war have been used to purchase Government securities in the market. That is really what has happened to the reserves.

The only remaining power we have is to raise regular reserve requirements in New York and Chicago, as I have indicated. This would be restrictive to a small degree but would be met by sales of short-term securities by those banks to the Reserve System. These banks, moreover, have shown relatively much less credit expansion than other banks.

For some months the Reserve System and the Treasury have been carrying out a program combining monetary, fiscal, and debt-management restraint on current inflationary bank credit expansion. Some moderate corrective rise has been permitted in wartime levels of interest rates on short-term Government securities, together with some adjustment in yields on long-term issues from low levels.

The certificate rate has gone up from seven-eighths to approximately one and an eighth. It has gone up a quarter of one percent, and the long-term rate, which was around two and a quarter, has gone up to close to two and a half. So that you are getting to the support point on the long-term securities.

The discount rates still remain at 1 percent, but there is no doubt that the discount rate will be increased at some time in the not too distant future in line with the short-term security price or rate. In other words, there is no point or use of maintaining what you call a preferential discount rate, a discount rate at less than the certificate rate.

The discount rate has been for a considerable period of time slightly above the certificate rate. It has been at 1 percent, and the certificate rate at seven-eighths; so, if that same slight differential was maintained in the future, the discount rate would be—that would make the discount rate one and a quarter, making it slightly above the one and an eighth certificate rate.

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In addition, excess funds in the Treasury balances arising from current budgetary surpluses have been applied to the retirement of the maturing bank-held Government securities.

The System has also urged all banks to maintain conservative standards in extension of consumer credit and has joined with other Federal and State supervisory agencies in recommending that all banks pursue conservative lending policies and enumerating here what we have done up to the present time.

They say that we have all of these powers and we should use them, and I am indicating here that this modest program has already been in effect. We are using existing powers, and there is a little more that might be done, such as the slight raising of the discount rate and increasing reserve requirements moderately in central Reserve cities, and such as the retirement of the public debt out of the budgetary surplus over the next 3 or 4 months, and such persuasion as we can exercise on the banks. That is about the program.

Representative HORAN. Along that line, Mr. Eccles, our subcommittee appeared in Seattle, and one of the witnesses to testify on this subject was Dean Howard H. Preston of the College of Economics and Business at the University of Washington.

After you testified here on November 25, I sent a copy of your statement to him, and despite the fact that he now has nearly 3,000 in his college, a part of the University of Washington, he took the time to write a 4-page letter immediately in reply, very much interested, and in that letter he stated when the 1945 report came out he turned thumbs down on it at that time.

He commented further to endorse your mildly deflationary activity, as he put it, and as he called it, and as you have just testified to now.

But in this paragraph, he says:

> As I stated above, I turned a cold shoulder on these proposals a year ago. Today conditions appear to me to be more critical. Drastic action undoubtedly is called for.

Now, this came from a man who has been a specialist in his lectures on the expansion of credit. He said he had preached it for 30 years, and it was a very important element.

Now, what I would like to have is a response from you of several suggestions that he makes here. One is from a competent economist, he says, who offers this suggestion:

> The Government should offer a refunding issue of various maturities and at various rates, but rates adequate to attract investors' money. The purpose of this should be partly to get the debt safely funded, and partly to get the debt out of the hands of the banks and the Federal Reserve banks, with a corresponding reduction of the swollen volume of bank deposits, swollen Federal Reserve deposits and money in circulation.
>
> To protect those banks which now hold an excessive volume of long-term Governments from ruinous losses in this process, banks should be allowed to subscribe to the new issues with their old ones, the old ones being received at the discount of 2 percent from par in making the exchange. The banks should be required in this process to take issues of shorter maturity in exchange for their long-term bonds. The FDIC should be treated in the same way.

Mr. ECCLES. In the first place, it is a fine theory, but every effort has been made to refund the debt, and the whole sales program of the Government to sell E, F, and G bonds is certainly for the purpose of getting in the hands of savers and investors as much of the public debt as you can possibly get in their hands, and any surplus coming from that source is used to pay off bank-held debt.

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But when investors' savings have fallen as rapidly as they have this year due to the increased cost of living, the amount of funds to invest has been very greatly diminished.

Further than that, the inflation itself has called for an increased use of capital funds, mortgage money and otherwise. It takes twice as much or more to build a house as it did, and, therefore, what used to be a $5,000 mortgage would today be a $10,000 mortgage, and your inflation is using up the existing savings.

Representative HORAN. We recognize that. Could not this be an attempt to find a usable substitute for the deficiency in savings moneys at that time?

Mr. ECCLES. There is deficiency in current cash savings, not in the opportunity to invest. The opportunity to invest is greater than the supply of money in the hands of savers, and so what he is talking about is to get the public to buy Government securities and pay off the bank-held debt.

I am saying that is what is being done, and has been done continuously. The question is whether you are going to be able to do any more than you are doing. I question that very much because of the opportunity for other investments.

Now, he makes another point with which I do not agree.

Representative HORAN. This is not Dean Preston. He just threw this in as a suggestion that came from somebody whom he considered competent.

Mr. ECCLES. I would not agree at all with the idea of these different rates of interest on these issues, because so long as you are supporting the longest-term rate on the market issue, then it seems to me that other market issues—if you put them out at a higher rate, then the issues you have at two and a half are going to go below par. You cannot put out a 3-percent bond or a three and a half, without automatically causing a flood of sales of the market securities that are now out.

Representative HORAN. Here is another suggestion that he includes, Mr. Eccles. I will not name the man; he does; he calls him a sound monetary economist, and he proposes a freezing of the Government bond holdings of banks, insurance companies, and other financial corporations.

Mr. ECCLES. Well, this is mild compared to that.

Representative HORAN. This is very drastic.

Mr. ECCLES. It is an attempt to hold half of their Government securities, and you do not freeze them. You merely require that they maintain a reserve and the option to hold about one-third of their Government security holdings in this reserve.

The effect would be to freeze these holdings because it would be in their interest to freeze this much of their holdings in short-term securities, rather than, of course, hold idle cash. But to require the banks to freeze a hundred percent of everything they have got, as this person proposes, is very drastic.

Representative HORAN. I raise these points for information. I would like to ask you a few more questions here.

Mr. ECCLES. I wonder if I could finish this statement, if I may, for the record.

Representative HORAN. I have got to get back to another committee meeting.

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Mr. Eccles. Very well.

Senator Watkins. How much longer is your statement, Mr. Eccles?

Mr. Eccles. It is about two-thirds through.

Representative Horan. This should not take too long, if we speed up the answers. I just wanted to say this is indicative to me of the tremendous interest in this field.

In your statement to us November 25, you stated that the power of the Federal Reserve Board to raise the reserve requirement of the banks in New York and Chicago from 20 to 26 percent would be of little value since—

> any action taken would have an effect on banking conditions only in two cities in which the credit expansion, as well as deposit growth, has been relatively less than for the rest of the country.

I wonder if you would explain to the committee a little more fully this variation in credit expansion by areas and cities.

Mr. Eccles. Well, it is difficult for me to say briefly why that is. The New York and the Chicago banks, particularly the New York banks, are strictly commercial banks. The banks outside, most of the country banks, are commercial as well as savings. The banks outside New York and Chicago have been making a very large volume of mortgage loans. They have also been making a very substantial volume of consumer credit loans, as well as some farm loans. These have been in addition to a very rapid expansion in their commercial and industrial loan. Thus, the banks outside have been making a variety of loans, whereas the loans, particularly in New York, and less so in Chicago, have been making almost entirely commercial loans.

Representative Horan. Would any treatment of that field have to be flexible for that reason?

Mr. Eccles. No.

Representative Horan. It would not?

Mr. Eccles. No.

Representative Horan. In your testimony you spoke at length about bank money being as purely inflationary as though it were fiat money turned out by the Government printing press. It has been estimated at the end of 1945 there were $95,000,000,000 flying around in the amount of excess purchasing power, for which there were no corresponding goods to buy. Somebody suggested that those were the flying saucers that appeared out in our area. What is that amount today?

Mr. Eccles. I could not possibly say.

Representative Horan. Is it greater or less?

Mr. Eccles. The amount of money is greater, of course, as I have indicated; that is, the volume of deposits and currency. We have some charts here that we use to show what that growth has been since before the war, and it is about three times what it was before the war; whereas the total physical volume of goods is twice, possibly one and three-quarters of what it was before the war. So money supply already has grown far more than our capacity for furnishing goods and services.

Representative Horan. Would any restriction on credit have a depressing effect upon production?

Mr. Eccles. Well, it would first have an effect upon demand. You restrict credit and where the demand exceeds the supply, the effect

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of the credit restriction is, of course, on the demand. If you got a credit restriction tight enough to force an actual substantial contraction of credit, when the supply caught up with the demand, then it would affect production. But its effect on production under these conditions would come secondarily.

Representative HORAN. It is not a danger at that time?

Mr. ECCLES. No; I do not think it is a danger at all. You need, first, to reduce the demand, and the demand is far in excess of the supply so that the supply would still be supplied so long as the demand was there.

Representative HORAN. On page 4 of your statement, in the second half of section 2, you state that business profits after taxes are more than double what they were any prewar year, and almost double the profits in any war year and, therefore, business should hold down prices or should reduce them.

Are not business profits derived from risk venture unlike fixed income from investments, such as bonds or, in other words, should not a definite distinction be made between profits from risk venture which should follow the purchasing power of the dollar in the same manner as is ascribed to demand for wage increases by labor? That was the tough one in your testimony.

Mr. ECCLES. Well, it is like the question of which is first the hen or the egg. You get, as I indicated, increased wages, increased prices, increased profits, increased credit. Certainly profits are a part of prices, and just as wages are, and I indicated in that statement that I gave that wages should be held down, that there should be no further increases, especially in the organized labor groups; but likewise, profits, which are also a part of prices, should be held down, and prices should be held down rather than add to profits through increasing prices.

In other words, labor would never certainly expect to hold wages if business profits continue to grow or even are maintained at their present high level.

Representative HORAN. What proportion of the increase of bank loans may be ascribed to increased cost of carrying inventories necessary in manufacturing operations?

Mr. ECCLES. I do not think there is any way of measuring that. Some companies have had to borrow to carry inventories; others have had balances that have been lying idle, and they merely put them into circulation.

Representative HORAN. That is all, thank you, Mr. Chairman.

Senator ECTON. Mr. Chairman, may I ask Mr. Eccles a question? You mentioned a while ago that it took twice as much money now to do the job as it did originally, or as it did over the past few years before we had this inflationary period.

Now, if we wish to maintain production, how do we dare restrict bank credit any further? Is it not dangerous, Mr. Eccles?

Mr. ECCLES. Well, I think it is more dangerous not to. It seems to me that when you get a growing inflationary situation, that you have got to choose the lesser of evils. You can either try to hold it by harnessing controls, such as we had during the war, so that the effects of the supply of money do not become fully effective, or you have got to try to keep the volume and the supply of money through credit from continuing to grow, because if it grows, after you have reached your capacity production, it cannot help but put pressure on

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prices. As I said, a restriction of credit does not stop bank lending operations. There is certainly nothing in the plan that we have proposed here, which is mild enough, that would prevent banks from making loans.

There would be some restraint on them; they would be more selective. The banks have been out beating the bushes to make loans; they have been spending a great deal of money on advertising, and trying to induce and get people to come in and borrow money. They have been inviting people to use their money in this consumer credit field, which is almost a new field for banks.

They are doing everything that they possibly can to get people to use money. They are not sitting there just waiting to take care of the necessitous loans for production, and it is because the source of credit reserves through the Federal Reserve is so easily accessible merely by selling a few short-term Government securities, and making loans at higher rates.

Senator ECTON. Did they not lose a lot of that business when they got too tough before and drove borrowers to other agencies, Government agencies and private lending agencies?

Mr. ECCLES. No. The bank's outstanding credits today are far in excess of anything they have ever been. The total amount of loans and investments of the banking system today as compared with prewar is almost double.

The CHAIRMAN. I noted, Mr. Eccles, that Mr. Brown's statement yesterday was not correct, and I questioned it at the time, that there had been no increase in deposits, but they had sold as many Government bonds as they had increased loans.

As a matter of fact, the chart seems to show in 4 months the loans and discounts have increased by $3,300,000,000, and there has been no reduction in Government obligations, and there has been an increase in deposits of $4,000,000,000. That makes the increase of bank credit distinctly an inflationary element; does it not?

Mr. ECCLES. It does; and I want to show you this chart here.

The CHAIRMAN. Is there any reason since October 29 that you expect the slowing-up in this process?

Mr. ECCLES. There has been no reason to expect it. We expect the opposite.

November was still the same. It has not changed at all. That is the month of November. We have the figures on that now.

The CHAIRMAN. Can you bring that chart over nearer to the committee?

Mr. ECCLES. This will give you a vivid picture of really what has happened in this development of money in relation to production.

I think we better have the loans and then show you how that shows up in the deposit structure because that is the opposite side of the ledger.

You will notice here that mid-1945 was about your low point in bank loans [indicating] and they were somewhere here about $15,000,000,000. You notice what happened here. They hit up here in 1941, after the war started to about $20,000,000,000.

Then as the Government credit started going up here, the Government began to put a lot of money into deficit financing.

The CHAIRMAN. Banks began to loan to the Government instead of to other people?

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Mr. ECCLES. Yes; loans went down. Then they began to do both. But since 1943, starting right here, there has been your trend, and it has not changed a particle. You will notice that.

Now in the case of Government securities you see what has happened there. This is a decline in the holdings of governments but that decline is largely out of the proceeds from the Eighth War Loan drive which was unnecessary.

They raised twenty-some-odd billion dollars and kept it in the war loan deposit account and later turned around and paid off the debt of banks and that is where the big change came.

Now you notice the holdings of governments by banks is leveled right off here since that has been applied.

Even other securites you notice tended up. There has been an increase of other securities, mostly municipals, I suppose, of a billion and a half dollars during the last 2 years.

Here is the reflection of it in the supply of money.

Here is what has happened to your currency situation.

You notice currency is pretty steady. In 1931 to 1933, it went up from around $4,000,000,000 to $5,000,000,000 due to hoarding, not due to increased circulation but hoarding because the banks were closed and you did not have availability of bank checks.

That continued, and you notice up here, to the end of the war and it leveled off.

Here is what has happened to adjusted demand deposits. That is a reflection of this bank-loan picture. That is the demand deposits with government's and the interbank taken out.

Here is savings deposits. They are leveling right off. Current saving is going down very rapidly throughout the country.

Senator O'MAHONEY. Mr. Eccles, will you turn back to the other chart, please?

Mr. ECCLES. Just before doing that, I would like to say; this is the total of deposits and currency. That gives you some idea. You notice that has gone up from here, a total from around $40,000,000,000 of currency demand deposits and time deposits. You will notice it has gone up here from around $40,000,000,000 to more than $160,000,000,000.

That gives you some idea of the supply of the means of payment. Without any further bank-credit expansion at all, if that gets a normal velocity, it still could create substantial inflation without adding to the supply because the supply of goods and services today have not caught up, even at the inflated prices and the increased production with the supply of money.

Senator O'MAHONEY. If you will turn to the other chart, I have a question or two.

Mr. ECCLES. Yes, sir.

Senator O'MAHONEY. It would appear from this chart that from 1942 to 1945 the bank loans were rising at the same time that Government securities were rising. That is to say the banks were loaning to the Government at a very heavy rate because we were in the war and to business at a more or less moderate rate.

But the rise of the loan line on your chart from 1945 to 1947 is much more rapid. The line representing Government securities held by the banks dropped very sharply at the beginning of 1945 when this $20,000,000,000 of the surplus sale of bonds took effect.

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Mr. ECCLES. It was 1946 it dropped. The Treasury started to retire securities at the beginning of '46.

Senator O'MAHONEY. In 1946, that is right. And the bonds then were running from 1944 to 1946 and from 1946 on they have been rising much more rapidly.

My point, however, is that after the application of that $20,000,000,000 of cash, the application of Government funds on the reduction of the debt was apparently restricted to the small surplus, about $750,000,000 on June 30 last; but we have the situation, therefore, that while the Government debt has been reduced the bank credit, that is to say, the private debt, is increasing.

Now my question is, If this bank credit continues to rise at the present trend, and you have testified that the figures for November would indicate that the trend is still up?

Mr. ECCLES. That is right.

Senator O'MAHONEY. If it continues to rise while the Government debt remains stationary or is reduced only slightly, is not that proof positive that unless we control the bank credits, the inflationary situation will continue?

Mr. ECCLES. Well, it certainly will continue so far as the supply of money is contributing to it and, of course, without an excess supply of money in relation to goods and services you could not have inflation.

Senator O'MAHONEY. Let us talk about the trend.

Mr. ECCLES. Right.

Senator O'MAHONEY. The trend of bank credit is up on top of this huge public debt and that is a decided inflationary factor; is it not?

Mr. ECCLES. That is true.

Sanator O'MAHONEY. Let me ask one more question.

I understood Mr. Brown, when he testified here yesterday, to disagree with the statement that had been made by you in your original testimony here which, as I recall, was to the effect that the lifting of the discount rate would necessarily be accompanied by a decline in the market value of Government bonds.

Mr. Brown contended that you could raise the discount rate and still support the bonds.

Mr. ECCLES. Well, yes; but it would be purely meaningless. In other words you are maintaining a rate of 1⅛ on Government certificates and, say, 1 percent on Government bills and the banks have no reserve requirement to hold any amount of them, and you raise the discount rate to as much as say 2 percent, no bank is going to be holding a 1 percent or 1⅛ percent short-term Government security and come in and borrow and pay 2 percent.

Therefore, the discount rate is meaningless so long as the door is completely opened to Reserve Bank credit through selling to us securities they have got in such abundance.

The CHAIRMAN. The open market and the discount rate go right together.

Mr. ECCLES. Absolutely.

If you had special requirement where a certain percentage of the deposits would have to be held in cash or short security, then you could raise the discount rate which would be effective insofar as short-term credit is concerned.

I do not think you could raise the discount rate indefinitely. You could raise it to 2½ percent, but if you get beyond that rate, even with

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the reserve requirement, it would then effect the long-term market sufficiently seriously to nullify it by supporting the long-term market.

Senator O'MAHONEY. What I wanted to be sure of, was your not modifying the statement you made the other day.

Mr. ECCLES. Not at all.

The CHAIRMAN. Will you finish your prepared statement?

Mr. ECCLES. This program of restraint has helped to reverse the processes that contributed so strongly to the wartime expansion of bank credit, and will be carried on as the proposed special reserve plan is not a substitute for this program, but may be necessary to supplement and reinforce it.

Despite the pressures of fiscal policy during September and October, which drew upon bank deposits and permitted retirement of over $1,000,000,000 of Government securities held by the banking system, deposits of businesses and individuals at commercial banks increased by $2,500,000,000, reflecting largely extension of bank loans to businesses, consumers, and owners of real estate.

Current reports indicate that the expansion of credit to these groups of bank customers continues to be at an unduly rapid rate.

Will the special reserve plan unduly restrict bank loans for productive purposes, handicap production in catching up with demand and thereby defeat its anti-inflationary purpose?

The present situation, as the Board emphasized in its annual reports for 1945 and 1946 and has been reemphasized time and again in the Federal Reserve Bulletin, is one of effective demand in excess of available supplies of goods, and of effective demand being continuously fed by still further expansion of bank credit.

There can be considerable reduction in the volume of demand without bringing it below available supplies of goods and upsetting production. Such a contraction of demand is essential to avoid further price increases. When a situation is finally reached where supply exceeds demand, that will be the proper time to encourage credit expansion. The Board's proposal is not a one-way street.

It would not prevent banks from making essential loans. It is designed, rather, to encourage banks to make loans out of the existing supply of loanable funds, replacing one loan with another or selling securities which the public or other banks will purchase. It would accept the present volume of outstanding bank loans, amounting to nearly 37,000,000,000, as a huge revolving credit pool for the financing of necessary production and permit banks to sell off other assets to make loans if this pool proved inadequate.

What it would not do is to permit banks to go on expanding the total volume of their loans by selling securities which only the Federal Reserve will buy, thereby creating additional reserves, which can be expanded by the banking system into loans and investments amounting to six or more times their amount.

Some would argue that bank loans at this time which are accompanied by increased production are not inflationary or are even anti-inflationary. This argument is of dubious validity because the money once created by loans and spent by the borrower finds subsequent uses which are beyond the control of the banker or the borrower and are highly inflationary in character.

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In describing the recent loan expansion, and its inflationary effects, the November issue of the Federal Reserve Bulletin states:

> * * * to the extent that the loans have not facilitated increased production, loan expansion has accelerated inflation. In addition, the deposit funds created in the first instance by loans, whether for production, consumption, or speculation purposes, have found many inflationary uses in subsequent transfers among holders.

What the plan cannot do is to reduce the existing volume of bank deposits. The only way this total can be reduced is by paying off in the aggregate the public and private debt held by the banks as assets against these deposits. This is inevitably a slow process at best.

Could the special reserve plan be applied without resulting in a violent upset in the Government securities market? There is no reason why the transition could not be accomplished in an entirely orderly manner. The introduction of the proposal would be gradual. Any bank that might not be able to meet the proposed special reserve requirement introduced in this gradual way on the basis of their present holdings of short-term Government securities should get into a more liquid position.

I should like to submit for the record a table showing for each major group of insured banks the relation of available special reserve assets on June 30, 1947, to selected levels for the proposed special reserve requirement.

The table also shows the percentage holdings of short-term Government bonds which these groups of banks held at mid-year, which were available for sale in the market to obtain eligible assets. This table makes clear the feasibility of the plan from an operating standpoint.

Of course, statistics for individual banks would show wider variations in holdings of eligible assets than are indicated for the table for groups of banks, inasmuch as aggregates conceal individual bank variations. However, the table should allay fears that the plan would have disruptive effects.

Would the imposition of the plan perhaps lead to deflation and depression? A fear expressed by some bankers who have discussed this Board's plan publicly—and they include those who are prepared to renounce the use of monetary and credit controls for anti-inflation purposes—is that the use of this plan might upset the present state of high production and overfull employment and induce severe deflation and depression. The object of the plan is not to bring on deflation, but to minimize the deflation that is inevitable if we follow a let-nature-take-its-course policy.

The Board recognizes that the proposal is no panacea and that there would be some risks in its use. But it would be an important restraint available to be used, and to be used only, in the event of continued inflationary banking developments.

Any anti-inflationary program involves some risk of precipitating a downturn and readjustment in business conditions. It would have been better to have had the power available for use earlier. Had the Reserve System been given the additional power that was recommended in the special report in 1940, it would no doubt have used it in view of developments during and since the war.

There is some feeling within the Reserve System that it will be held responsible for deflation if even the mildest use of this requirement

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should happen to coincide with a deflationary readjustment. It is because of this possibility that the Board is not eager to have the grave responsibility for using the authority.

Nevertheless, the Board feels that the System should not shrink from bearing its share of responsibility for restraint on further inflationary developments in the credit field.

Is the special-reserve plan strong enough to accomplish its expressed purposes?

We have been at pains to draw a plan that would be moderate and equitable and at the same time capable, when applied in conjunction with other monetary and fiscal policies, of accomplishing the purpose of restraining further inflationary expansion of bank credit. This is the sole objective of the plan. We think the authority would prove adequate for the purpose in view.

It would immobilize, at the maximum, less than one-half of the wartime growth in bank holdings of Government securities which in turn equals about one-half of the deposits of individuals and businesses at commercial banks. Since the immobilization of this volume of Government securities would greatly reduce the banks' available secondary reserves, which they now feel free to draw upon, the plan would certainly make many banks more cautious about seeking or making new loans. It would end aggressive solicitation of new loan business in which a great many banks are actively engaged.

Another source of pressure on the banks that would result from the plan is that most of the banks would have to sell higher-rate issues from their holdings of Government securities in order to expand loans and maintain reserve positions. This would be more effective, from the standpoint of restraining banks, than would a rise in the discount rate.

It would have this effect without causing a rise in interest rates on short-term Government securities. Thus, the proposed measure would be another step in a program of keeping the banks under constant pressure to restrain further credit expansion. It would not force liquidation or reduction in total bank credit outstanding. It would discourage expansion.

Can the plan be effective without permitting or encouraging a rise in interest rates?

Some bankers and others seem to believe that the only effective mechanism for the restraint of inflationary bank credit is a rise in the general level of interest rates. We doubt whether a reasonable rise in short-term interest rates under present conditions of business profitability would deter borrowers. We do not believe it would deter lenders. Our plan places the restraint primarily on the lender.

However, to the extent that the interest rate mechanism can have some effect, the Board's plan would not interfere with it. Any increased cost resulting from the plan would be borne by private borrowers who are increasing their indebtedness, and not by the Government which is reducing its indebtedness. This is the only reasonable solution to the interest rate problem.

A general rise in interest rates high enough to halt the current inflationary expansion of bank credit would not only entail large added costs to the Government but would have a disastrous effect upon the Government bond market.

(The charts referred to are as follows:)

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Assets and liabilities of all commercial banks in United States, June 1947 to October 1947

[Amounts in millions of dollars]

Item	June 30, 1947	July 30, 1947 [1]	Aug. 27, 1947 [1]	Sept. 24, 1947 [1]	Oct. 29, 1947 [1]
ASSETS					
Loans and investments	112,756	113,370	113,970	115,280	116,440
Loans and discounts	33,679	34,010	34,880	35,560	36,940
U. S. Government obligations	70,539	70,650	70,330	70,800	70,540
Other securities	8,538	8,710	8,760	8,920	8,960
Reserves, cash, and bank balances	32,704	31,950	32,210	33,190	33,820
Reserve with Federal Reserve Bank	16,039	16,280	16,440	16,760	16,790
Cash in vault	1,847	1,990	2,040	2,100	2,150
Balances with banks in United States	8,947	8,790	8,930	9,270	9,380
Balances with banks in foreign countries	41	40	40	30	30
Cash items in process of collection	5,830	4,850	4,760	5,030	5,470
Other assets	1,514	1,610	1,670	1,560	1,690
Total assets	146,975	146,930	147,850	150,030	151,950
LIABILITIES AND CAPITAL					
Gross demand deposits	100,772	100,480	101,310	103,180	104,770
Deposits of banks	11,349	11,260	11,480	12,120	12,100
Other demand deposits	89,423	89,220	89,830	91,060	92,670
Time deposits	35,135	35,170	35,240	35,400	35,530
Total deposits	135,907	135,650	136,550	138,580	140,300
Borrowings	64	250	230	290	440
Other liabilities	1,125	1,170	1,170	1,220	1,200
Total capital accounts	9,879	9,860	9,900	9,940	10,010
Total liabilities and capital accounts	146,975	146,930	147,850	150,030	151,950
Demand deposits adjusted	82,276	83,260	83,450	84,260	85,530

[1] Partly estimated. Figures have been rounded to nearest 10 million.

Source: Board of Governors of the Federal Reserve System, Division of Bank Operations, Dec. 3, 1947

Assets and liabilities of all banks in the United States, Oct. 29, 1947

[Partly estimated. In millions of dollars]

Item	All banks [1]	All commercial banks [1]	Member banks: Total	Central reserve city banks: New York	Central reserve city banks: Chicago	Reserve city banks	Country banks
ASSETS							
Loans and investments	135,160	116,440	97,983	20,434	5,034	36,205	36,310
Loans and discounts	41,780	36,940	31,530	7,054	1,756	12,909	9,811
U. S. Government obligations	82,750	70,540	59,171	12,163	2,896	20,853	23,259
Other securities	10,630	8,960	7,282	1,217	382	2,443	3,240
Reserves, cash, and bank balances	34,490	33,820	29,596	6,101	1,610	11,656	10,229
Reserve with Federal Reserve bank	16,790	16,790	16,791	4,347	1,054	6,602	4,788
Cash in vault	2,220	2,150	1,635	143	26	548	918
Balances with banks in United States	9,970	9,380	5,794	58	144	1,836	3,756
Balances with banks in foreign countries	30	30	26	12	2	9	3
Cash items in process of collection	5,480	5,470	5,350	1,541	384	2,661	764
Other assets	1,930	1,690	1,443	325	41	580	497
Total assets	171,580	151,950	129,022	26,860	6,685	48,441	47,036

See footnotes at end of table, p. 616.

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Assets and liabilities of all banks in the United States, Oct. 29, 1947—Con.

Item	All banks [1]	All commercial banks [1]	Member banks				
			Total	Central reserve city banks		Reserve city banks	Country banks
				New York	Chicago		
LIABILITIES AND CAPITAL.							
Gross demand deposits	104,780	104,770	90,737	22,486	5,279	33,701	29,271
Deposits of banks	12,100	12,100	11,824	4,175	1,150	5,455	1,044
Other demand deposits	92,680	92,670	78,913	18,311	4,129	28,246	28,227
Time deposits	53,190	35,530	28,385	1,478	885	11,370	14,652
Total deposits	157,970	140,300	119,122	23,964	6,164	45,071	43,923
Borrowings	440	440	417	171	60	136	50
Other liabilities	1,290	1,200	1,061	478	40	383	160
Total capital accounts	11,880	10,010	8,422	2,247	421	2,851	2,903
Total liabilities and capital accounts	171,580	151,950	129,022	26,860	6,685	48,441	47,036
Demand deposits adjusted	85,530	85,530	72,121	16,404	3,663	25,084	26,970

Figures have been rounded to nearest 10 million.

Board of Governors of the Federal Reserve System. (For immediate release.) Dec. 1947.

Changes in assets and liabilities of all banks in the United States, June 30, 1947, to Oct. 29, 1947

[Partly estimated. In millions of dollars]

Item	All banks [1]	All commercial banks [1]	Member banks				
			Total	Central reserve city banks		Reserve city banks	Country banks
				New York	Chicago		
ASSETS							
Loans and investments	+4,060	+3,680	+3,182	+102	+232	+1,594	+1,254
Loans and discounts	+3,410	+3,260	+2,875	+506	+192	+1,468	+709
U. S. Government obligations	+70	--------	−27	−408	+6	+8	+367
Other securities	+580	+420	+334	+4	+34	+118	+178
Reserves, cash, and bank balances	+950	+1,120	+902	−142	+89	+415	+540
Reserve with Federal Reserve Bank	+750	+750	+751	+181	+81	+328	+161
Cash in vault	+290	+310	+226	+20	−10	+78	+138
Balances with banks in United States	+290	+430	+273	+8	−18	−28	+311
Balances with banks in foreign countries	−10	−10	−8	−8	+1	−1	--------
Cash items in process of collection	−370	−360	−340	−343	+35	+38	−70
Other assets	+230	+170	+142	+10	+5	+64	+63
Total assets	+5,240	+4,970	+4,226	−30	+326	+2,073	+1,857
LIABILITIES AND CAPITAL							
Gross demand deposits	+3,990	+4,000	+3,376	−197	+242	+1,718	+1,613
Deposits of banks	+750	+750	+842	+49	+70	+572	+151
Other demand deposits	+3,240	+3,250	+2,534	−246	+172	+1,146	+1,462
Time deposits	+630	+390	+311	+19	+14	+101	+177
Total deposits	+4,620	+4,390	+3,687	−178	+256	+1,819	+1,790
Borrowings	+380	+380	+367	+170	+60	+125	+12
Other liabilities	+80	+70	+65	−35	+5	+74	+21
Total capital accounts	+160	+130	+107	+13	+5	+55	+34
Total liabilities and capital accounts	+5,240	+4,970	+4,226	−30	+326	+2,073	+1,857
Demand deposits adjusted	+3,250	+3,250	+2,526	−90	+236	+918	+1,462

[1] Figures have been rounded to nearest 10 million.

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The CHAIRMAN. Mr. Eccles, I asked Mr. Brown yesterday whether there was the same opposition on his part to simply giving the Board the power to raise the reserve rate perhaps 10 percent. He said they ought not be so far apart.

Supposing you started with 10 at the bottom and raised the other a little less so that you came out with 20, 25, or 30 or something of that kind. How much effect do you think the use of that power would have?

Mr. ECCLES. It would have some, but I think you would find, if we proposed authority merely to increase reserve requirements, that immediately the opposition to the proposal I have here would be shifted, and they would be more willing to accept this proposal.

The CHAIRMAN. What you mean is, if you were going to raise it to 20, 25, or 30, the banks themselves might come in and say, "Let us put a proportion of that into short-term Governments."

Mr. ECCLES. There is not any question about it, because if you increase reserve requirements the banks immediately lose that much of an earning asset.

Our proposal is less onerous than any proposal we could suggest.

The CHAIRMAN. A certain part of the opposition seems to be that it would enable greater manipulation of the Government bond market. I got that impression.

Mr. ECCLES. By whom? Today you have 14,000 banks that have been manipulating the Government bonds' market.

The CHAIRMAN. The fact is you have guaranteed a market for a certain amount of Government bonds.

Mr. ECCLES. We have had that for some time.

The CHAIRMAN. As you yourself suggested, it enables you to maintain the rate at a different rate from what it would be if the thing were wide open.

Mr. ECCLES. That is right, but the question of manipulating markets, the people that have been manipulating the market, or, at least, have taken advantage of bond profits have been the banks.

Over the period of the last 5 or 6 years, if you look at the bank statements, the consolidated statements of the banks, you will see how much they have taken advantage of the speculative opportunity of making money in Government securities. They have made hundreds of millions of dollars by their manipulation of the market.

The CHAIRMAN. I would not say by their "manipulation" of the market. If the market goes up, they sell them and that tends to bring them down again.

Mr. ECCLES. I am not censoring them at all. All I do not want them to do is to censor us in saying this gives us a chance to manipulate the market.

What this does, it merely enables the Board to have a little better control over their available supply of Federal Reserve credit.

Today we have no control.

As long as we support the market, the short market and long market as we are doing, the banks just have access to Federal Reserve credit, and this would give us some restriction on that.

We would have to continue to support the market just as we are doing. The banks could buy and sell Governments in the market, taking such advantage of prices in the future as they have been able to do in the past, but I feel sure there would be a far greater stability in the market, and there would be less opportunity to do that.

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I feel that the banks, if the authority existed, even without putting it into effect, that the banks coming into possession of reserves from gold imports or coming into possession of reserves that they may get as a result of us supporting the long-term market by purchasing securities held by insurance companies and nonbank investors, would take those funds and would buy the short-term securities instead of being under pressure to make loans with those reserves they get from those two sources.

The banks likewise would be likely to shift from their intermediate and longer bonds and get more of the securities that would be eligible to the special reserve requirement.

That would not necessarily upset the market at all, because the Federal Reserve would merely transfer the short-term securities that they have to the banks and the banks would transfer their intermediate or longer securities to the Federal Reserve. That is really what would happen where the banks do not have sufficient amount of excess cash or securities to meet the reserve requirement.

The banks have got themselves to blame to the extent that they have played what we term the pattern of rates by selling short-term securities, getting reserves which enabled them to go out and buy six times that many of the long-term securities.

That is what has been happening, and that is why they drove the rate on bank eligible securities down and the prices of the securities up.

Where the real opposition comes today, and particularly from New York and Chicago banks, is that those banks do not have anywhere near enough short-term securities. They have plenty of long, and they would have to reverse the process. I claim that the banking system should have at least half their Government securities in short-term securities, and if they do not have them they should undertake to get them.

The CHAIRMAN. Why should they have them? I do not quite see that. They are all marketable and the Government is maintaining the price of long-term Governments. Why should not banks invest in them?

Mr. ECCLES. Except you maintain the 2½.

The CHAIRMAN. They are marketable on your own theory. You have a policy which says they are absolutely marketable and liquid. Why should not they take the return?

Mr. ECCLES. Because there is a wide fluctuation in the intermediate securities. In other words, the 2-percent bond, for instance, eligible to the banks went down to about 1½ percent yield. It is back up to 1¾ percent yield and many of the banks that bought the securities to take high coupon shifted from the short securities and now find that the market has gone off two or three points, and we do not peg the market on intermediates.

We are not guaranteeing them that when they bid these prices up on those bank-eligible securities.

The CHAIRMAN. You are guaranteeing they are not going below par, are you not?

Mr. ECCLES. What we have done in the 2½-percent bonds and short-term certificates, we have protected the market at par. As a matter of fact, the ⅞-percent certificates, when we raised new certificate rates to 1 percent, were below par. When the 1⅛ certificates were issued the 1-percent certificates went below par.

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But we felt it absolutely necessary to support the 2½ long-term Governments rates.

In-between rates have fluctuated much more widely. The banks have very large premium accounts in those intermediate securities, and I know of instances where they had a big book profit but their bonds have gone off very substantially in the last 2 or 3 weeks. However, I think most banks possibly still have some book profit. Where they had very large book profits and did not sell, their profits have to a considerable extent disappeared.

The CHAIRMAN. Mr. Eccles, going back to the statement of your conference with Secretary Snyder, that has been put in the record?

Mr. ECCLES. Yes; I put that in before you came.

The CHAIRMAN. Do I understand from this, you feel in the immediate future, the next month or two, the Government surplus applied to the running off of bonds, the payments of bonds, will more or less meet the need for drastic deflationary action to be taken for the next several months?

Mr. ECCLES. I stated that in my testimony on the 25th when I appeared before the committee.

The CHAIRMAN. How much is that?

How much is the bond debt likely to be reduced between now and the 1st of March?

Mr. ECCLES. We estimate it will be not less than about $7,000,000,000; that there will be pulled out from the market in taxes commencing now with December 15, and running over to the middle of March, that the surplus for the year will pretty largely come right in that quarter. Those funds, of course, will come out of the banks, and the banks in order to meet that withdrawal of funds will have to sell securities.

We estimate the banks will have to sell at least $7,000,000,000.

The CHAIRMAN. You think that will be a deflationary influence on the increased bank loans?

Mr. ECCLES. Yes. I think it will be a factor. Certainly the banks will not feel as easily as they would if they were losing no deposits and no Governments. Their deposits will be going off in tax payments, and they will have to sell Governments to meet the reserve requirements.

I know the psychological effect of such developments on the banks. I do not mean they do not make loans, but they will not be out beating the bushes to get them as they have been.

The whole attitude, as deposits go off and they lose Governments, which serve as secondary reserves, has a desirable effect.

The CHAIRMAN. You think it is reasonable for us to take the position that this is a temporary taking care of the matter. I think this thing is so complicated I do not want to try to get anything through before Christmas. It seems to me we are entitled to take the month of January to go into it further and make up our minds what the more permanent solution ought to be.

Do you think that is a reasonable position?

Mr. ECCLES. I think that is a reasonable position and a position I certainly expected the Congress to take when the statement was presented before this committee in the first instance.

I recognize it is a complex situation, and that there would be, of course, very violent opposition to it, but I did feel in proposing it

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that it would bring out the fact that Reserve System did not have the great powers that so many people said we had and we are not using; that the powers we had were powers that could only be used by practically ignoring our responsibility for maintaining an orderly market in supporting the Government structure.

The CHAIRMAN. I do not quite agree. I think there ought to be some point where that could be pushed a little further and you could see when the danger point was coming.

I do not quite agree it is all black and all white. If you use the powers beyond the proper point in government, that there is going to be a calamity.

Mr. ECCLES. We feel in the System, although Mr. Sproul and I do not agree on this reserve picture, we do agree very fully, and I think Mr. Brown agrees on this——

The CHAIRMAN. Mr. Brown agrees; yes.

Mr. ECCLES. The one thing you cannot do is to have confidence shaken in that 2½ percent rate. If you let that go below par, there is always a question, where does it go? Because people remember, a great many of them, what happened after the last war when they let those securities go below par.

I happen to have a statement of what really happened in that regard, and it is an amazing thing where, for instance, the 4¼ percent fully tax exempt securities, which were callable in 1933 and due in 1938, and which in 1920 had only 13 years to run before being called, went to in 1920. Those bonds went down to 82½ bid, to yield 5.78 percent to maturity. That yield was for maturity and not for the call date. The issue was a totally tax-free security.

That is what happened in 1920 when there was only $26,000,000,000 of total public debt. Now the public debt is two hundred and fifty-some-odd billion, or 60 percent of the total of public and private debt, whereas then the Government debt equaled only a fraction of the total debt.

The CHAIRMAN. My question is one of great degree. Do you have to keep 2½ percent money indefinitely, forever. Can you say that we are going to prevent inflation and yet pursue an easy money policy and absolutely maintain the 2½ percent rate?

In order to do that, you are trying to get all sorts of other controls in lieu of that.

Mr. ECCLES. Not all kinds, merely a simple reserve requirement here. It is not anything. The bankers have made it appear what it is not. They want to make it appear complex.

Senator O'MAHONEY. It is a question of whether we are going to manage the debt or let the debt manage us.

Mr. ECCLES. That is correct, and we have done a great deal of thinking of this management of the public debt, and I can assure you that job of managing $258,000,000,000 of public debt is a very difficult one. It is not simple, and it is not easy, and we start out from the premise that the public credit and the interest of the public in savings bonds must be maintained; that we must try to get the people to draw money off and get it into savings, and we want them to hold the savings bonds that they have.

Now it is true that if the inflationary situation continues, prices continue to go up, that that in itself would cause the sale of more market bonds held by nonbank investors in order to buy other securities with greater yields.

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I mean that is the difficulty, and that, of course, would create reserves, and that is why this proposal would help to offset some of those reserves that were created.

Now, to the extent that the inflational spiral is broken here, the demand for investment funds would, of course, be diminished, because as prices go down money would go further.

The same amount of mortgage money with a decent construction situation would have built many more houses than is the case today.

If the price structure is stabilized or is brought down, that in itself helps to break the pressure of the long-term Government market, and that in itself would tend to increase savings.

People, with the high cost of living, find it difficult to save, and they are having to cash in some of their savings so that the inflation itself actually tends to defeat a savings program, and it tends to create such a demand for long-term capital at higher rates than 2½ that there may be some pressure on the sale of 2½'s. If, with that sale of 2½-percent bonds reserves that are created by our support of the market were covered by an increase in reserve requirements, it would help.

It is really not a special reserve, just an increase in reserve requirements. An inflow of gold might be offset by an increase in reserve requirements in the same way. Then, if the surplus from the public debt is actually used as an anti-inflationary measure in forcing banks to sell some of the securities they hold, the increased reserve requirement authority would give us an effective means of controlling changes in the over-all credit situation. But, as it is today, gold imports, and the purchase of bank-held or nonbank securities gives reserves to the banks, so that the effects of current budget surplus are being nullified.

For instance, if you have a budgetary surplus of $2,000,000,000 and $2,000,000,000 of gold in, then if the $2,000,000,000 of budgetary surplus is used to sterilize the gold, it is not available for anti-inflationary measures to bank-held debt.

If the Federal has to buy $2,000,000,000 of nonbank securities from insurance companies and others in the process of maintaining the market, that puts $2,000,000,000 of excess reserves into the banking system, and therefore another $2,000,000,000 of the budgetary surplus is necessary to sterilize that. If we could increase reserve requirements that would automatically sterilize the effect of the gold imports, and it likewise would sterilize the effective support of long-term 2½-percent market.

The CHAIRMAN. Let me ask something about the import of gold. That gold all gets to the Federal Reserve bank, does it not?

Mr. ECCLES. Yes. The process is the Treasury buys it and pays for it, and that money goes into the banks and becomes deposits in excess reserves.

The CHAIRMAN. One moment.

We will say the Russians ship gold in here; what do they actually do with it?

Mr. ECCLES. It is turned over to the Treasury.

The CHAIRMAN. They sell it to the Treasury?

Mr. ECCLES. That is right.

The CHAIRMAN. And the Treasury gives them dollars for it?

Mr. ECCLES. And then the Treasury turns around and gets money from the Federal Reserve and gives us a gold certificate. The gold is then sent to Kentucky.

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The CHAIRMAN. In effect, it is turned over to the Federal Reserve bank and you get notes for it or deposits?

Mr. ECCLES. What happens is the Treasury gets dollars to reimburse themselves for the dollars they pay to whoever buys the gold. They get a credit.

The CHAIRMAN. So the net result is the reserve gets a certificate crediting the gold, and against that they have again issued additional amount of notes equal to that gold. Is that correct?

Mr. ECCLES. Well, when the Treasury pays, we will say the Russians, or English, or whoever ships the gold, and actually pays for the gold, those dollars become deposits in American banks and are spent.

The CHAIRMAN. They become first deposits in the Federal Reserve?

Mr. ECCLES. If a central bank, the Bank of England for instance, yes.

The CHAIRMAN. I mean the Treasury gets the deposit, Mr. Eccles?

Mr. ECCLES. They are reimbursed periodically. Gold transactions are going on all the time and when the Treasury accumulates an amount and they want to be refunded they just issue certificates. They may have 50 million; they may have 500 million; and they can just reimburse their account by issuing certificates to the Federal Reserve and getting dollars whenever they want to.

In the meantime what has happened is the dollars they have paid for the gold have gone into our banking system and have become deposits and excess reserves in the hands of the banks.

The CHAIRMAN. And as far as creating purchasing power is concerned, it is just the same as if a bank made a new loan and created the deposit?

Mr. ECCLES. A lot worse than that. When they make a loan they reduce their ratio of reserves to deposits. When the gold comes in, it creates purchasing power, and the amount of reserves are increased by the amount of the deposit. That is the difference. That is the difficulty. The same thing is true when the Reserve System purchases bank or non-bank-held Government securities.

The CHAIRMAN. What do you estimate the gold imports of 1948? Have you any estimate at all?

Mr. ECCLES. Yes, we have. Of course, it is pretty difficult to say, but we think it will not be less than a billion and a half. We think that is a conservative estimate, and we think more likely it will be around two billion. That in itself is the basis of a lot of credit.

The CHAIRMAN. Thank you.

Any questions?

Senator ECTON. Mr. Chairman, this may be beside the point. If Mr. Eccles would care to comment on it, I would be glad to have him.

We refer to this period as "inflationary." You refer to it as that, I do, and everybody does. And in comparison with the 1939 period, of course, it is inflationary.

But is it not necessary that we move into a relatively higher price range?

Mr. ECCLES. We have so moved.

Senator ECTON. All down the line in order to take care of this 258 billion in national debt?

Mr. ECCLES. We have moved into a higher price range, and I do not think we are ever going to get back to a prewar price range.

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It has been suggested that if we could stabilize the cost of living at something like 50 percent above the 1935–39 averages that that should be a good and a satisfactory job.

Nobody is trying to get back to the 1935–39 averages, figuring that at 100, but we would like to get back to around 50 percent above that, and at the present time we have exceeded the 50 percent and it is continuing to go up.

I do not think anybody expects that the prices are going back to prewar. That is impossible. The credit structure of the country could not be sustained, your employment could not be sustained on any prewar volume.

Mr. Chairman, I have a statement here that I would like to put in the record. It is the proposal for a special reserve requirement against demand deposits, and that explains it very completely.

It says, "the need for the special reserve requirement" and explains it, "a need for Federal Reserve supported Government securities market."

All of these questions that have been asked have been covered there.

This chart of loans and investments is here.

Then, limited effectiveness of the increase in the rates of Government securities; purpose of special reserve; the features of the special reserve plan.

It covers the whole thing.

Then we come over to the operations of the proposal, reduced availability of secondary reserve assets, lower multiple expansion ratio, influence of existence of power to impose requirements, reenforcement of other instruments of credit restrictions, and then bank lending for the essential needs not prevented.

Then we come to the advantages of the proposal.

I do not think there is a question that the committee could ask of me or others that that does not answer.

The CHAIRMAN. All right.

(The document referred to is as follows:)

PROPOSAL FOR A SPECIAL RESERVE REQUIREMENT AGAINST THE DEMAND AND TIME DEPOSITS OF BANKS

(Board of Governors of the Federal Reserve System, Washington, D. C., December 5, 1947)

In order to provide a more effective means of restraining inflationary expansion of bank credit, the Board of Governors of the Federal Reserve System proposes that Congress pass legislation granting the System's Federal Open Market Committee temporary authority to impose gradually as conditions may warrant a requirement that all commercial banks hold a special reserve. This reserve should be in addition to reserve required under existing laws. It should be calculated, within limits fixed by law, as a percentage of demand and time deposits and should consist of Treasury bills, certificates, or notes, balances with Federal Reserve banks, cash or cash items, or interbank balances.

NEED FOR THE SPECIAL RESERVE REQUIREMENT

This special requirement would make it possible for the Federal Reserve System to immobilize a portion of these assets. This immobilization, however, would be only for the purpose of preventing their use for the purpose of obtaining additional reserves to support expansion of credit to private borrowers. Moreover, as gold acquisitions create bank reserves, they could be offset by an equivalent increase

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in the special requirement. The additional requirements would also reduce the possible multiple expansion of bank credit on the basis of any increase in reserves.

At present high levels of employment and output, further expansion of the total volume of bank credit is inflationary because it would increase the active demand for goods and services, which is already in excess of the productive capacity of this country's existing industrial structure and labor force.

So long as the public debt is as dominant a part of the country's financial structure as it is at present the Federal Reserve System has a responsibility for maintaining orderly conditions in the United States Government security market. In practice this means that the System stands ready to purchase Government securities offered for sale if they are not taken by other purchasers. Whenever the Federal Reserve buys Government securities, additional bank reserves are created and these in turn supply the basis for an expansion of bank credit of more than six times the amount of the reserves.

Ability of banks to increase reserves.—Commercial banks currently hold about $70,000,000,000 of Government securities. As is shown in the chart, this sum exceeds their prewar holdings by more than $50,000,000,000 and is about three-fifths of total loans and investments. In addition to this great expansion in holdings of Government securities, commercial banks also have increased their loans and holdings of other securities. Transfer of any part of these Government securities to the Federal Reserve banks creates reserves on which a sixfold expansion of credit can be built. The potential inflationary expansion of the money supply is thus enormous. Reserves arising from gold acquisitions or Federal Reserve purchases of securities from nonbank investors may add still more to this potential.

The opportunity which the banks now have to create new reserves on their own initiative by selling Government securities to the Federal Reserve System is not a long-established right, but is one of the heritages of war finance. In wartime the Federal Reserve System was under obligation to provide banks with sufficient funds to purchase Government securities in excess of those sold to nonbank investors. After the war, the necessity of providing a stable and orderly market for the vast public debt outstanding has in effect made the Federal Reserve System the ultimate or residual market for Government securities. So long as this situation continues and the banks are free to use their Government securities to obtain reserves at will there is no effective restraint on bank credit expansion.

Prior to the war, the ability of banks to expand credit was limited by the existing supply of bank reserves, which was largely subject to Federal Reserve control. Except during the period of large gold inflow which brought an excessive volume of reserves, the available supply of bank reserves was determined principally by the volume of member bank borrowing from the Reserve banks or by Federal Reserve purchases and sales of bills and securities in the open market. These open market operations were definitely regulated in amount so as to provide the supply of reserves required by the economy. Variations in prices and yields on Government securities were an incidental result of these policies.

Need for Federal Reserve support of Government securities market.—Under present conditions large-scale and continuous Federal Reserve open market operations are essential to the maintenance of an orderly and relatively stable market for Government securities and are a necessary adjunct of the Treasury's program for managing the economy's huge public debt of $260,000,000,000. The System often purchases and sells securities amounting to hundreds of millions of dollars in a week. On October and November, System purchases totaled 3.2 billion dollars, sales 1.2 billion, redemptions of maturing issues 2.1 billion, and exchanges of maturing for new issues 8.2 billion. Large-scale Federal Reserve transactions are at times essential for the maintenance of a market for Government securities. In view of the System's greatly enlarged responsibilities for the Government securities market and in view of the volume of such securities now held by banks, the System no longer has adequate power to influence the potential volume of bank credit in the way it could before the war.

It is illuminating to know the extent to which public debt has become a dominant factor in the country's financial structure. The United States Government debt, which was never more than a third of private and other debt before 1941, is now one and a half times the remaining debt. That part of the public debt which is marketable amounts to $167,000,000,000, compared with 69,000,000,000 of stocks and 15,000,000,000 of non-Government bonds listed on the New York Stock Exchange and an estimated 13,000,000,000 of marketable securities listed on other stock exchanges throughout the country.

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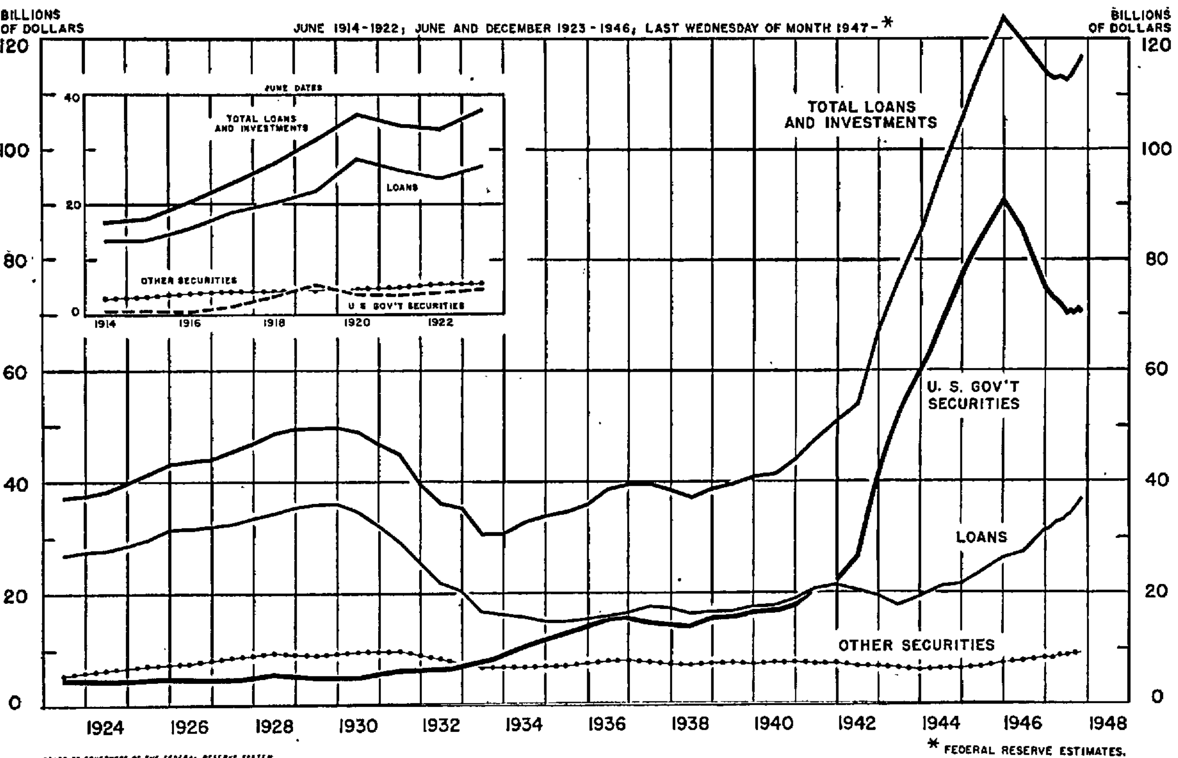
LOANS AND INVESTMENTS OF ALL COMMERCIAL BANKS
JUNE 1914-1922; JUNE AND DECEMBER 1923-1946; LAST WEDNESDAY OF MONTH 1947-*
BILLIONS OF DOLLARS
120
100
80
60
40
20
0
1924
1926
1928
1930
1932
1934
1936
1938
1940
1942
1944
1946
1948
TOTAL LOANS AND INVESTMENTS
U. S. GOV'T SECURITIES
LOANS
OTHER SECURITIES
JUNE DATES
TOTAL LOANS AND INVESTMENTS
LOANS
OTHER SECURITIES
U S GOV'T SECURITIES
40
20
0
1914
1916
1918
1920
1922
* FEDERAL RESERVE ESTIMATES.

Today, Government securities are widely held as liquid investments which can be readily sold and, therefore, transactions in them are likely to be frequent. This liquidity rests in considerable part on having the Federal Reserve System provide a residual, assured market for purchase and sale of Government securities.

In these circumstances, it would be entirely inadequate for the Federal Reserve System merely to revert to the prewar practice of purchasing and selling only definite amounts of securities, determined solely on the basis of the economy's need for bank credit or for the purpose of offsetting the effects of gold or currency movements on bank credit. The System needs to take into account, in addition to other factors, conditions affecting the Government security market. Traditional actions through discount-rate policy are largely irrelevant, because the banks have little or no occasion to borrow funds to maintain reserve positions so long as they can sell Government securities for this purpose.

Since the Reserve System has to engage in constant buying and selling of United States Government securities on a large scale, the prices or rates at which these transactions are effected are necessarily determined by the System. In fact, under present conditions, the structure and level of interest rates on Government securities which the System helps to maintain in the market have become the principal expression of Federal Reserve policy instead of the volume of purchases and sales.

Limited effectiveness of increase in rates on Government securities.—Control of interest rates on Government securities, however, is not an effective instrument for achieving monetary objectives. A moderate rise in yields on Government securities will not prevent, and will only slightly restrain, banks from selling securities in order to make loans. An increase in rates large enough to exercise real restraint on banks would generally be too great or too abrupt to be consistent with the maintenance of stable conditions in the market. Even an intimation that such a policy might be followed may lead to a flood of selling. The System might find itself under the necessity to support the market and in the process might create more reserves than it would have created through meeting the demands of banks in an orderly market. This is the postwar monetary paradox.

Purpose of special reserve.—The special reserve proposal is designed to place some restriction on the newly-acquired privilege of banks to obtain at will more reserves on which to make more and more loans. It is not, as has been asserted by some of its critics, a revolutionary device to compel banks to hold Government securities. The proposal contains no such compulsion. If any bank chooses to hold the special reserve in cash or on deposit with another bank or with a Reserve bank it would be free to do so. At the same time the proposed measure would not require banks to reduce their holdings of Government securities.

The proposal would give the Federal Reserve System no new power to interfere with bankers in running their own banks but it would restore to the System some of its previously held authority to exercise regulatory power over the available supply of bank reserves. There is nothing new or revolutionary in that.

Under the proposed authority it would be possible to insulate a part of the Government securities market from private credit and permit the Federal Reserve System to use open market operations and discount rates more freely to affect conditions in the private credit market. Thus, the authority would make it possible to limit the volume and raise the cost of private credit without necessarily increasing the interest cost to the Government on an important part of the large public debt outstanding.

FEATURES OF THE SPECIAL RESERVE PLAN

Special features of the proposed temporary authority may be briefly summarized as follows:

(1) Banks subject to the provisions would be required, in addition to their regular reserves, to hold a special reserve consisting of—

(*a*) Obligations of the United States in the form of Treasury bills, certificates and notes (with original maturities of 2 years or less); or

(*b*) Cash items, as defined in the next paragraph, to the extent that their total exceeds 20 percent of gross demand deposits plus 6 percent of time deposits.

(2) For this purpose cash items would include the following:

(*a*) Balances with Reserve banks, including statutory required reserves.

(*b*) Coin and currency.

(*c*) Cash items in process of collection.

(*d*) Balances due from in excess of balances due to banks in United States.

(3) The special reserve requirement would apply to both demand and time deposits and would be subject to a maximum limit fixed by statute. A maximum

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of 25 percent of gross demand deposits and a maximum of 10 percent of time deposits will probably be adequate for the temporary period covered by the proposed statute.

(4) The requirement would apply to all banks receiving demand deposits, including member banks of the Federal Reserve System and nonmember banks—insured and noninsured. It would not apply, however, to banks that do exclusively a savings business.

(5) The power to impose and to vary the special reserve requirement would be vested in the Federal Open Market Committee and would be limited by law to a temporary period of 3 years.

(6) The requirement would be introduced gradually as credit conditions warrant The authorizing statute could provide that, after a special reserve has been established of 10 percent against gross demand deposits and 4 percent against time deposits, further changes would not exceed 5 percent of gross demand deposits and 2 percent of time deposits at one time. Ample notice should be given before the effective date of the initial application of the requirement, or of subsequent changes, to allow banks adequate time to make adjustments.

(7) The following considerations should determine the timing of the introduction of, or changes in, the special reserve requirement:

(*a*) The volume and ownership of special reserve assets and of other assets readily convertible into eligible assets;

(*b*) Past and prospective gold movements, currency fluctuations, or other factors causing changes in the volume of bank reserves;

(*c*) Conditions in the Government securities market; and

(*d*) The general credit situation.

(8) Special reserves and requirements would be computed on a daily average basis for monthly periods, or for other periods by classes of banks as the Open Market Committee might prescribe. The penalty against average deficiencies in the requirement would be one-half percent per month, payable to the United States.

(9) The Federal Open Market Committee would be authorized to issue regulations governing the administration of the requirement, to require necessary reports, and to delegate administration with respect to nonmember banks to other appropriate Federal or State banking agencies.

OPERATION OF THE PROPOSAL

Establishment of the special reserve requirement would accomplish two principal purposes: (1) It would reduce the amount of Government securities that banks would be willing to sell to obtain additional reserves; and (2) it would decrease the ratio of multiple-credit expansion on the basis of a given amount of reserves. These results could be accomplished without reducing the volume of earning assets of banks.

Reduced availability of secondary reserve assets.—The special reserve requirement would not deprive banks of any earning assets but would reduce the available amount of highly liquid and readily salable assets which banks hold as secondary reserves to meet losses of deposits and new credit demands. Because of the reduction in these operating secondary reserves, banks would be less willing to sell Government securities held in excess of the requirement in order to acquire higher-yielding loan or investment assets. Thus, an effect of the special reserve requirement would be to reduce the creation of new reserves and expansion of bank credit through sale of Government securities to the Federal Reserve.

Lower multiple-expansion ratio.—Reduction in the ratio of multiple credit expansion on the basis of any addition to the supply of reserves would be an important effect of the special reserve requirement. How great a reduction from the present ratio of 6 or more to 1 would result from the proposal will depend on the percentage requirement established. It would also depend on the banks' holdings of assets eligible for the special reserve and their ability to acquire them from sources other than the Federal Reserve. It is not feasible to estimate the extent of the reduction in the ratio—but under present conditions—with the easiest source of the needed reserve material being the Federal Reserve banks—the ratio, at the maximum required rate of special reserve, may conceivably decline from the present figure of 6 to as low as 2½.

Influence of existence of power to impose requirement.—The existence of power to impose a special reserve requirement would itself exert a strong restraining influence on bank-credit expansion. Banks would need to guide their policies with an eye to the possible imposition of the requirement. The extent of use of

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the special reserve requirement would necessarily depend on developments in the general credit situation.

Reinforcement of other instruments of credit regulation.—Other instruments of Federal Reserve policy could be so used as to facilitate adjustment to the new requirement and subsequently would be employed to apply such additional restrictions or such easing as the general credit situation might require. From the monetary point of view the principal purpose of the proposed new requirement is to make possible the more effective use of the existing instruments in offsetting changes in bank reserves—particularly open-market operations and discount rates—without seriously upsetting the Government securities market and unduly raising the interest cost on the public debt.

The Federal Open Market Committee, which would have authority to apply and vary the requirement, is composed of all seven members of the Board of Governors of the Federal Reserve System and five representatives of the Federal Reserve banks. The Committee's present authority covers the System's Government security and other open-market operations. The use of the proposed special reserve requirement would be closely related to these operations.

Bank lending for essential needs not prevented.—Restraints on further bank-credit expansion by the proposed requirement, supplemented as the situation may warrant by other credit control measures, would not prevent the accommodation by banks of the economy's essential credit needs. The additional reserve requirement, however, would put the banks under pressure to attempt to meet essential credit demands out of existing loanable funds. To expand loans, banks would need to sell securities of types that might be bought by other investors, rather than short-term Government securities which under present conditions are purchased principally by the Reserve banks.

ADVANTAGES OF THE PROPOSAL

Rise in interest rates largely limited to private credit.—The proposed measure has many important advantages over alternative means of curbing credit expansion. It is frequently suggested that restraint on further bank credit expansion could be accomplished by allowing short-term interest rates, both on public and on private credit, to rise substantially, thus increasing the cost of borrowing and thereby seeking to deter borrowing. It is doubtful that such a policy would effectively deter borrowing, and, in any event, it would greatly increase the cost to the Government of carrying the public debt and might have disruptive effects on the Government securities market. Under the proposed authority, interest on private credit could be raised without increasing rates on Government securities. In other words, the higher rates would be paid by those who are currently engaged in inflationary borrowing and who might be deterred by them. These rates would not be paid by the Government, which is reducing its indebtedness.

Restraint on lender.—Restriction of inflationary expansion of total bank credit to private borrowers can be more effective if the restraint is placed primarily on the lender. Under present conditions, even such a substantial rise in short-term interest rates as one or two percentage points would not deter many borrowers, and might encourage further lending because of the additional profit inducement to the lender. Under the proposed measure, the restraint is placed primarily upon the lender, that is, the banking system. By limiting the ability of the banks to make credit available, the proposal would thus be a retarding influence on further bank credit expansion. As already stated, banks would not only charge more for loans they make to private borrowers but would be more cautious in extending such loans. The latter may be a more important restraint than the former. Higher rates are not an effective deterrent in boom conditions but difficulty in obtaining credit is a powerful restraining influence.

Preferable to increase in regular reserve requirements.—It has been suggested that the same result might be achieved by an increase in existing basic reserve requirements of banks. If this were done, however, banks would have to meet the increase by selling Government securities which the Federal Reserve System would have to buy in order to supply the needed reserves. This would decrease the banks' earning assets and their earnings, whereas the proposed special reserve measure would enable them to retain earning assets. The continued profitability of bank operations is essential if the banks are to meet their increasing costs and build up adequate reserves while serving their communities constructively.

To increase primary reserve requirements would also raise difficult jurisdictional, legal, and administrative problems with reference to nonmember banks, whereas the specific form of the proposed special reserve requirement, as more fully described in the next section, is designed to fit the sort of banking system

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that exists in this country without alterations in its structure or drastic changes in its customary methods of operation. Banks that are not members of the Federal Reserve System would have to be included. Limitation of the requirement to member banks only would seriously weaken the Federal Reserve System by giving a great advantage to nonmembership and therefore would make the measure ineffective, as well as inequitable. The new measure, as proposed, would assure equitable treatment of individual banks and groups of banks without requiring that all banks become subject to a single authority. The proposed requirement would also make use of the practice of interbank deposits without interfering with the system of correspondent relations.

In summary, the proposal would require banks to hold a large portion of the Government securities which they were encouraged and permitted to buy to aid in war finance and still allow them to meet all essential credit needs of the economy. It would assure the maintenance of a high degree of liquidity and safety in the banking system during a period of rapid and uncertain economic change. It would not necessitate changes in existing banking structure or procedures.

The Board believes that the proposed plan is the most effective and practical method of dealing with the present monetary and credit situation because it assures that the pressures will be exerted at the places where restraint on bank credit expansion is needed, namely, in the field of private loans. At the same time the plan will protect the interests of the Government, the general public, and the banking system.

FORMULA FOR COMPUTING THE SPECIAL RESERVE REQUIREMENT

As explained earlier, the special reserve requirement might be placed as high as 25 percent of demand deposits and 10 percent of time deposits or at some lower level. The assets that would be counted as special reserves include Treasury bills, certificates of indebtedness, and notes having original maturities not exceeding 2 years, as well as certain specified nonearning or cash assets in excess of 20 percent of demand deposits and 6 percent of time deposits. This deduction makes a uniform allowance for required regular reserves and other customary operating funds of banks. Computation of the formula is illustrated in table 1 attached.

Reasons for selection of Government securities to be included in special reserve.—Only Treasury bills, certificates, and short-term notes are proposed for inclusion in the special reserve and other Government securities are eliminated for a number of reasons. The volume of bills, certificates, and notes can be more easily limited to relatively stable amounts. Inclusion of Government bonds within 1 or 2 years of maturity or call dates would result in wider variability in the total outstanding amount of eligible reserve assets. To include all Government securities would make necessary a very high reserve requirement in order to be an effective restraint. Since banks holding deposits subject to withdrawal on demand or short notice should maintain a high degree of liquidity, securities which are short term at issuance are more appropriate assets for them to hold as reserves.

The inclusion of longer term, higher rate securities in the formula would make it possible for banks to continue to shift their lower rate issues to the Federal Reserve and to purchase higher rate bonds in the market. Unless requirements were very high most banks would have an excess of special reserve assets and could sell short-term securities to the Reserve System. Limitation of the requirement to bills, certificates, and notes with low coupon rates would make it necessary for banks to sell their higher rate issues in order to expand loans. This would be more of a discouragement to lending than sale of low-rate, short-term issues and also the higher rate issues would be bought more readily by others than the Federal Reserve. Finally, the limitation would improve the market demand for reserve-eligible issues and help to maintain a lower rate on short-term Government borrowing without lowering long-term interest rates, which are an important source of income for investors of savings.

Reasons for including cash assets.—The proposed eligible cash assets include balances with the Federal Reserve banks, coin and currency, cash items in process of collection, and balances due from, in excess of balances due to, other banks in the United States. However, only the excess of the sum of these items over an amount needed for required reserves and other customary operating funds customarily held by banks would be counted in the special reserve. A level of 20 percent of gross demand deposits, and 6 percent of time deposits, uniform for all banks, is proposed as an equitable statutory amount for these customary operating funds. What the banks hold above this amount will be eligible to count as special reserves. Banks of all classes typically hold these cash items in an aggregate

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amount equal to the sum of about 25 percent of gross demand deposits and 6 percent of time deposits.

Provision in the formula for some margin of cash assets, as well as the specified short-term Government securities, is desirable to accomplish the purposes of the special reserve authority. Confining the eligible special reserve assets to Government securities would cause difficulties to banks obtaining new funds and not holding adequate amounts of the required securities; they should be permitted to count their cash as reserves until they could acquire, or in case they could not acquire Treasury bills, certificates, or notes. Banks ought not to be compelled to buy such short-term securities in order to meet the proposed special reserve requirement, if for operating reasons they prefer to hold excess cash assets. Cash holdings, moreover, are even more effective in meeting the purposes of the requirement. From the standpoint of avoiding credit expansion, a formula limited to short-term Government securities would be less effective than one which includes cash in the special reserve.

Allowance for differences in banking laws and procedures.—An equitable formula should allow for the great variations that exist among groups of banks with respect to basic reserve requirements and with respect to holdings of different types of cash assets, without interfering unduly with these requirements and practices. If the requirement were limited to member banks, only excess reserve balances at Federal Reserve banks and the specified Government securities might be allowed to count as special reserves. Reserve requirements for nonmember banks, however, not only differ from those for member banks but also vary from State to State. For nonmember State banks, balances due from banks constitute the major part of reserves required by State law, and the excess of such balances over statutory requirements comprise other operating funds, or secondary reserves. Member banks hold their required reserves, and perhaps some excess, on balances with the Federal Reserve banks, but member banks also hold balances with correspondent banks as part of their operating or secondary reserve funds. Both nonmember and member banks would undoubtedly prefer to continue the practice of holding part of their operating funds as balances due from other banks.

Permitting banks to count all of their balances due from other banks in cash items eligible as special reserve assets would present an opportunity for building up fictitious reserves through the pyramiding of interbank balances by multiple exchange of deposits among banks. To prevent such a development, insofar as practicable, the special reserve plan would permit balances due from other banks to be counted as eligible assets only to the extent that they exceed balances due to other banks. Any other treatment of interbank deposits would invite evasion and jeopardize the objectives of the plan.

The proposed formula for the computation of cash assets eligible for satisfying the special reserve requirement treats member and nonmember banks alike, insofar as differences in practices and laws permit. It avoids interference with established correspondent relations, and, in fact, makes use of these relations. In the interests of administrative simplicity, the proposed formula is uniform for all banks.

AVAILABILITY OF SPECIAL RESERVE ASSETS

The formula and its application to certain broad groups of insured banks, using aggregate figures as of June 30, 1947, is illustrated in table 1 attached.

Differences by groups of banks.—The table shows that banks in each major group have an excess of cash assets over the minimum allowance and also have more than enough special reserve assets available to meet a requirement established at 10 percent against gross demand deposits and 4 percent against time deposits. At the statutory maximum suggested for the requirement—namely, 25 percent against demand deposits and 10 percent against time deposits—the different groups show deficiencies in holdings of eligible assets of varying percentage amounts. New York City banks held the smallest amounts of eligible assets relative to their deposits, while country member and nonmember banks held the largest amounts.

The variation in the percentages of deficiency or excess in special reserve assets at the selected levels is still wider, of course, when studied by groups of banks according to Federal Reserve districts. This point is illustrated in table 2 attached, which is also based on figures for June 30, 1947. Each group in each district would be able to meet the lower level of requirements used. Data for individual banks would show even greater differences than appear for the groups of banks in table 2, and some banks might have deficiencies in holdings of eligible assets even at the lower requirement level.

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Adequate supply of special-reserve and other liquid assets.—In considering the deficiencies in eligible special reserve assets that banks might confront at certain requirement levels, it must be remembered that banks hold substantial amounts of short-term Government bonds that may eventually be refunded by the Treasury into eligible assets or that could be converted through the market into such assets. In general the Federal Reserve would purchase the bonds and sell banks reserve-eligible securities. Holdings of short-term bonds as percentages of gross demand deposits at mid-1947 are also shown in table 2.

According to figures relating to the ownership of the public debt on September 30, 1947, shown in table 3 attached, all commercial banks hold about $15,000,000,000 of Treasury bills, certificates, and notes,[1] and in addition $6,000,000,000 of bonds due or callable within 1 year and $30,000,000,000 of bonds within 1 to 5 years. These holdings were widely distributed among individual banks. As these bonds mature or are called they may be refunded by the Treasury through issuance of securities eligible to be held as special reserves. The amount of Treasury bills, certificates, and notes issued can be made to depend on the need of the banking system and the demand for such assets.

As table 3 indicates, moreover, the Federal Reserve System holds $22,000,000,000 of Treasury bills, certificates, and notes, which banks could acquire by selling to the System other Government securities. About $12,000,000,000 of eligible obligations are also held by nonbank investors, and these might be bought by banks. Thus the total of Treasury bills, certificates, and notes outstanding is nearly $50,000,000,000, compared with gross demand deposits at commercial banks of $100,000,000,000. The amount of such securities outstanding may be decreased through debt retirement or increased through refunding of bonds. It is estimated that, after allowing for probable reduction in total marketable debt and for refunding of all other retired issues into reserve-eligible securities, the total amount of such securities outstanding will continue fairly close to the present level for the next 3 years. The amounts held by banks may be increased by purchases from other holders.

Thus banks could readily obtain enough bills, certificates, and notes to meet a special reserve requirement of 25 percent. They could still hold substantial amounts of short-term securities as secondary reserves free for operating purposes, but the amount of such freely available funds could be materially reduced by the requirement.

TABLE 1.—*Illustrative computation of special reserve assets, June 30, 1947 (based on aggregate figures in millions of dollars, by groups of banks)*

Assets	Member banks				Nonmember insured banks
	Central reserve city		Reserve city	Country	
	New York	Chicago			
1. Gross demand deposits	22,683	5,037	31,983	27,659	11,891
2. Time deposits	1,459	871	11,269	14,475	6,349
3. Coin and currency	123	36	470	780	395
4. Cash items in process of collection	1,884	349	2,623	834	124
5. Excess of demand balances due from over demand deposits due to other banks in United States [1]				2,546	2,765
6. Balances with Federal Reserve banks	4,166	973	6,274	4,628	
7. Net cash assets [1] (3+4+5+6)	6,173	1,357	9,367	8,787	3,284
8. Deduct 20 percent of gross demand deposits plus 6 percent of time deposits	4,624	1,060	7,073	6,400	2,759
9. Excess cash assets [1] (7−8)	1,549	298	2,294	2,387	525
10. Treasury bills, certificates, and notes	2,015	606	4,874	5,191	2,932
11. Total special reserve assets [1] (9+10)	3,564	904	7,168	7,578	3,457

See footnote at end of table, p. 632.

[1] For simplicity of computation these figures include some notes which had original maturities of over 2 years and therefore would not be eligible as special reserve assets under the proposal. These, however, mature shortly and in any event could be readily shifted into reserve-eligible securities.

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TABLE 1.—*Illustrative computation of special reserve assets, June 30, 1947 (based on aggregate figures in millions of dollars, by groups of banks)*—Continued

Assets	Member banks: Central reserve city: New York	Member banks: Central reserve city: Chicago	Member banks: Reserve city	Member banks: Country	Nonmember insured banks
12. Special reserve required at given percentages:					
(a) 10 percent against demand and 4 percent against time deposits	2,327	539	3,649	3,345	1,443
(b) Maximum of 25 percent against demand and 10 percent against time deposits	5,817	1,346	9,123	8,362	3,608
13. Deficiency or excess of special reserve assets: [1]					
(a) With 10 percent against demand and 4 percent against time deposits	+1,237	+365	+3,519	+4,234	+2,014
(b) With 25 percent against demand and 10 percent against time deposits	−2,255	−443	−1,954	−784	−151
14. Percentage deficiency or excess of special reserve assets to demand deposits:					
(a) With 10 percent against demand and 4 percent against time deposits	+5.5	+7.2	+11.0	+15.3	+16.9
(b) With 25 percent against demand and 10 percent against time deposits	−9.9	−8.8	−6.1	−2.8	−1.3

[1] Figures shown for these items are computed on the basis of aggregates by groups of banks for the country as a whole; totals of figures computed separately for individual banks or from aggregates by districts would show somewhat different amounts of available cash assets for some of the groups.

TABLE 2.—*Ratios of available special reserve assets and short-term Treasury bonds to gross demand deposits, all insured commercial banks, June 30, 1947*

	Percentage of gross demand deposits						
	Treasury bills, certificates, and notes	Excess cash assets [1]	Total special reserve assets	Deficiency or excess of special reserve assets if requirements are—: 25 percent of demand and 10 percent of time deposits	Deficiency or excess of special reserve assets if requirements are—: 10 percent of demand and 4 percent of time deposits	Treasury bonds due or callable [2]: Within 1 year	Treasury bonds due or callable [2]: Within 1-5 years
Central reserve city member banks:							
New York	8.9	6.8	15.7	−9.9	+5.5	5.7	27.8
Chicago	12.0	5.9	17.9	−8.8	+7.2	4.2	23.4
Reserve city member banks:							
Boston	10.3	7.1	17.5	−8.6	+7.1	5.1	18.3
New York	9.3	9.4	18.7	−11.8	+6.5	3.5	31.7
Philadelphia	6.7	8.3	14.9	−11.3	+4.4	1.5	22.6
Cleveland	8.0	6.4	14.4	−14.2	+3.0	7.1	33.7
Richmond	12.9	7.4	20.3	−7.0	+9.4	2.5	32.5
Atlanta	14.4	8.7	23.2	−3.9	+12.3	3.5	20.0
Chicago	20.6	7.1	27.7	−2.7	+15.5	5.9	36.9
St. Louis	10.3	6.3	16.6	−10.2	+5.9	5.1	24.2
Minneapolis	8.8	7.3	16.1	−10.7	+5.4	3.7	28.0
Kansas City	16.8	6.0	22.7	−3.7	+12.2	4.8	19.1
Dallas	13.3	6.1	19.4	−7.1	+8.8	2.2	18.4
San Francisco	22.9	7.6	30.5	−.9	+17.9	6.1	31.3
Total	15.2	7.2	22.4	−6.1	+11.0	4.9	27.8
Country member banks:							
Boston	12.6	6.4	18.9	−11.1	+6.9	5.0	37.3
New York	12.7	9.3	21.9	−11.5	+8.6	4.3	45.7
Philadelphia	18.7	10.1	28.8	−4.4	+15.5	5.0	41.4
Cleveland	17.8	11.1	28.9	−3.5	+15.9	4.8	40.2
Richmond	17.0	8.5	25.5	−3.9	+13.8	4.3	31.8

See footnotes at end of table, p. 633.

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TABLE 2.—*Ratios of available special reserve assets and short-term Treasury bonds to gross demand deposits, all insured commercial banks, June 30, 1947*—Con.

	Percentage of gross demand deposits						
	Treasury bills, certificates, and notes	Excess cash assets [1]	Total special reserve assets	Deficiency or excess of special reserve assets if requirements are—		Treasury bonds due or callable [2]	
				25 percent of demand and 10 percent of time deposits	10 percent of demand and 4 percent of time deposits	Within 1 year	Within 1-5 years
Atlanta	19.7	5.1	24.8	−3.3	+13.6	3.9	25.0
Chicago	21.6	10.5	32.1	+.6	+19.5	5.9	41.8
St. Louis	21.7	3.8	25.5	−3.2	+14.0	4.0	28.7
Minneapolis	23.8	6.4	30.2	−.3	+18.0	7.3	39.8
Kansas City	26.1	9.6	35.8	+9.3	+25.2	3.2	18.8
Dallas	21.3	11.1	32.4	+6.6	+22.1	2.9	16.7
San Francisco	17.6	7.9	25.5	−4.9	+13.3	6.9	33.9
Total	18.8	8.6	27.4	−2.8	+15.3	4.7	34.3
Nonmember insured commercial banks:							
Boston	19.2	1.2	20.3	−15.8	+5.9	5.6	41.5
New York	15.1	1.7	16.8	−16.2	+3.6	4.5	39.9
Philadelphia	20.9	.3	21.2	−11.1	+8.3	3.8	35.6
Cleveland	22.0	4.8	26.8	−6.3	+13.5	4.6	37.6
Richmond	20.4	.2	20.6	−9.2	+8.7	5.8	29.5
Atlanta	25.2	6.8	32.0	+3.8	+20.7	3.0	22.9
Chicago	29.0	5.9	34.9	+3.1	+22.2	4.6	39.8
St. Louis	25.0	4.7	29.7	+2.7	+18.9	2.2	22.5
Minneapolis	39.6	3.9	43.5	+12.8	+31.2	6.4	32.5
Kansas City	28.0	7.3	35.3	+8.6	+24.6	2.9	20.5
Dallas	16.5	10.4	27.0	+.8	+16.5	.9	18.3
San Francisco	19.6	.6	20.1	−16.6	+5.5	7.7	39.3
Total	24.7	4.4	29.1	−1.3	+16.9	4.2	31.0

[1] Total of (1) balances with Federal Reserve banks, (2) excess of demand balances due from over demand deposits due to banks in United States, (3) coin and currency, and (4) cash items in process of collection, less (5) the sum of 20 percent of demand deposits and 6 percent of time deposits.
[2] These ratios are based on estimated holdings of such Treasury bonds.

TABLE 3.—*Ownership of marketable U. S. Government securities*

[In millions of dollars as of Sept. 30, 1947]

Investor group	Total [1]	Type of security			
		Bills, certificates, and notes	Treasury bonds maturing or callable—		
			Within 1 year	Within 1 to 5 years	After 5 years
Commercial banks	68,892	14,966	5,583	30,300	18,043
Federal Reserve banks	22,329	21,610	177	403	140
U. S. Government agencies and trust funds	4,387	81	50	362	[2] 3,858
Other investors	72,338	11,801	1,502	7,258	[2] 51,647
Total	167,946	48,458	7,312	38,323	73,688

[1] Total includes postal savings and prewar bonds not shown in break-down by issues.
[2] Most of the bonds due or callable after 5 years held by Government agencies and about 45 billion dollars of those held by other investors are not eligible for purchase by banks. About 7 billion dollars of these bonds may be acquired by banks.

Source: Data estimated on the basis of the Treasury Survey of Ownership of Securities issued and guaranteed by the United States.

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Senator FLANDERS. Mr. Chairman, there is one line of questions which I am not going to pursue today. I judge that Mr. Eccles is not considering this as emergency legislation to be finished at this session, but it seems to me we have had within only a few years' experience in the checking of an inflation, in 1937.

As you can see, on the curve of industrial production and wholesale prices——

Senator O'MAHONEY. What page is that?

Senator FLANDERS. Industrial production is page 63; wholesale prices, page 69.

And it seems to me we are not looking, or should not look at this thing without turning back to the experience of 1937. I suggest that we do that at some later time.

Mr. ECCLES. I shall be very glad to discuss that. That question was raised before and it was raised at the time I was before committees of Congress when that whole question came up, and the Board presented to the Banking and Currency Committees of Congress what they considered the reasons for that, which were primarily a budgetary situation due to, in 1936, the payment of the bonus, plus a large budgetary expenditure, and then a huge inventory expansion.

Inventories went up $5,000,000,000 in 8 months at that pirce level. Then we came along to 1937 and for a period of 8 months you had a balanced cash budget. You put social security in and you had no soldiers' bonus.

Senator FLANDERS. The interesting thing to me, Mr. Eccles, is that it is difficult to find any record of that inflation and deflation in the banking data. That is the interesting thing to me.

Mr. ECCLES. I do not think it was in the banking data because it reflected itself in a change in the velocity of money which is a very important factor.

It is not only the volume you have to consider.

At that time you had a lot of idle money. Today, as I pointed out, on these charts, you can have a very substantial increase in inflation without further bank-credit expansion because the supply of money is already of such proportion in relationship to your price level that given a velocity that we have had, for instance during the twenties, this volume of currency and deposits could carry a much larger national product than it is now carrying at this price level.

The CHAIRMAN. As I understand it, Mr. Eccles, we made the mistake of balancing the budget in 1938. Is not that the net result of the Board's views at that time?

Mr. ECCLES. I think so. I think the budget was not technically balanced. You took $2,000,000,000 out of the economy in social security in 1937.

In 1936 you paid $2,000,000,000 out to the soldiers, and you had in addition to that $4,000,000,000 public expenditure, so in 1937 you reversed the thing very quickly and added to that was the business reaction to the big expenditures, the bonus and all in 1936.

When they saw prices stabilizing and going up and they had small inventories, they started buying and the inventories of business increased $5,000,000,000 putting into circulation the money they had.

Then in 1937, you took $2,000,000,000 out to pay social security taxes and the Government did not spend as much for other purposes as they had in 1936 and business quit accumulating inventories and

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started to try to sell, and the net result is you got a prefectly natural reaction.

The Board has been accused of causing it by increasing reserve requirements. But at that time there was excess reserve. We did not have enough power to sterilize all of the gold that was here and even after we increased requirements to the full statutory limit, there still was large excess reserve and interest rates went up hardly at all.

The rate on commercial paper was still around 1 to 1½ percent. The rate on short-term Government securities, some of them bills, was about one-half of 1 percent, and the interest rate did not change at all during that period.

The CHAIRMAN. I have a third reason to suggest for that and that was such a rapid increase in wages was made that costs and prices could not keep up with them.

Mr. ECCLES. I think they may have been too rapid at that time. I think that is true in the building industry.

The CHAIRMAN. That is true in railroads. They were down so they could not spend money even on maintenance, much less capital investment, because wages had gone up so much. The automobile industry also.

Senator FLANDERS. I want to say, Mr. Eccles, this does raise in my mind the question whether there is such a direct relationship between the banking and monetary factors and the large sharp increases and decreases in prices and industrial volume.

The relationship is direct enough and sure enough so we can place dependence on them?

Mr. ECCLES. I agree with Mr. Sproul that you certainly should not rely solely, or to the greatest degree, on strictly monetary and credit action. But I think it is a factor you cannot ignore.

So far as the System is concerned, it certainly is an unpleasant and an unpopular position to be in, to apply any restraint because it will always affect a lot of people adversely no matter what is done, and I doubt very much in the Federal Reserve System at least, the personnel of it, could not survive the breaking of the boom if it created unemployment and deflation.

The CHAIRMAN. What about the administration, apart from the Federal Reserve System?

Mr. ECCLES. It depends which administration you are talking about, whether the administration in Congress or the administration downtown.

I am not in the political field. In our job we try to be perfectly detached and consider our job as being advisers on the financial and economic front. We just advise and Congress has got to make the decision.

The CHAIRMAN. Thank you, Mr. Eccles, and thank you for submitting these drafts.

(The drafts referred to are as follows:)

Hon. ROBERT A. TAFT,
Chairman, Joint Committee on the Economic Report,
United States Senate, Washington, D. C.

(Attention Mr. John Lehman, clerk.)

MY DEAR MR. CHAIRMAN: In accordance with the request contained in your letter of December 4, 1947, I am glad to enclose herewith a draft of a bill to carry out the proposal regarding special reserve requirements for banks, which I mentioned before your committee, together with a summary of the more important

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provisions of the proposed bill. I have furnished copies of this draft of bill to the chairman of the Banking and Currency Committees of the Senate and the House of Representatives.

I also enclose a draft of a proposed bill to reinstitute consumer credit controls, which is identical with a draft that I transmitted to the chairmen of the Banking and Currency Committees in June of this year, together with a memorandum stating the reasons why a bill of this kind is preferable to the enactment of a joint resolution. Even if it should be decided not to consider permanent legislation on consumer credit, this bill would still be appropriate with the addition of such time limitation as might be decided upon. If, however, it should be determined to use merely a joint resolution, I enclose a copy of a draft of such a resolution which could be used for this purpose.

I trust that the bill providing for special reserves and the bill to reinstitute consumer credit controls will receive the careful and favorable consideration of the Congress. I am sending you under separate cover for your convenience a number of the various documents mentioned above.

Sincerely yours,

M. S. ECCLES, *Chairman.*

SUMMARY OF PROPOSED BILL TO PROVIDE SPECIAL RESERVE REQUIREMENTS FOR BANKS

The attached bill proposes that, for a temporary period of 3 years, an authority be provided under which all commercial banks could be required, as an anti-inflationary measure, to hold a so-called special reserve in addition to existing requirements. This special reserve could be held in the form either of cash, cash items, interbank balances and deposits with Federal Reserve banks, or in short-term Government securities, that is, bills, certificates, and notes. It is proposed that the Federal Open Market Committee of the Federal Reserve System administer the authority within the limitation that the special reserve would not exceed 25 percent of demand deposits and 10 percent of time deposits.

Under existing conditions there are no effective limitations upon the ready availability of reserves, which the banking system obtains from three principal sources. First, when the banks sell some of their large holdings of Government securities in the open market and those securities are purchased by Federal Reserve banks, reserves are thereby created on which the lending power of the banking system is increased by a ratio of about 6 to 1. That is, for each dollar of reserves about six additional dollars of deposits can be created. Second, gold acquisitions automatically increase the reserves and deposits of the banking system. Third, when nonbank investors sell Government securities which are purchased by the Federal Reserve banks, this likewise creates additional bank reserves.

The broad purpose of this legislation is to provide under present and prospective conditions some restraint on the creation of bank credit beyond what is essential for the maintenance of full production. Proponents of this measure state that it should be closely integrated with Government fiscal policy and should be flexible in order to meet changing conditions.

The principal features of the proposed legislation are as follows:

Temporary period.—The law would be effective for a period of 3 years only.

Banks affected.—The requirement would apply to all banks receiving deman deposits, including member banks of the Federal Reserve System and nonmember banks—insured and noninsured. It would not apply, however, to banks that do exclusively a savings business.

Special reserve requirement.—A special reserve would be required against both demand and time deposits. The percentage of such special reserve could be varied from time to time by the Federal Open Market Committee (which consists of the members of the Board of Governors of the Federal Reserve System and presidents of five Federal Reserve banks) but would be subject to a maximum limit of 25 percent with respect to demand deposits and 10 percent with respect to time deposits.

Special reserve assets.—Special reserve assets which all banks may be required to maintain, in the percentage fixed by the Open Market Committee, would include (*a*) obligations of the United States in the form of Treasury bills, certificates, and notes with original maturities of 2 years or less, and (*b*) the excess of specified cash assets over an allowance for existing reserve requirements and for customary operating funds of the banks. This allowance would be fixed by statute at 20 percent of demand deposits and 6 percent of time deposits; and the specified cash assets which would be eligible for use in meeting the special reserve require-

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ment would consist of the following assets to the extent that they exceed the amount of this allowance: Balances with Federal Reserve banks, the net amount of interbank deposits, coin and currency on hand, and cash items in process of collection.

Fixing of percentages.—In prescribing the percentages of special reserve assets required, the committee must consider certain economic factors specified in the bill. Percentages initially fixed could not be greater than 10 percent with respect to demand deposits or 4 percent with respect to time deposits and could not thereafter be increased at any one time by more than 5 points as to demand deposits or 2 points as to time deposits. Sixty days' notice would be required before any increase could become effective.

Computations and deficiencies.—The amount of its required special reserve would be computed by each bank over a monthly period (or such shorter period as might be fixed by the Open Market Committee) and any deficiency in the amount of its special reserve during any month would be subject to a penalty of one-half of 1 percent. The penalty would be payable to the United States and if not paid could be recovered in a suit brought by the United States district attorneys upon request of the committee. The committee could waive the payment of penalities where the deficiency results from excusable error made in good faith.

Reports.—Banks would be required to furnish to the Open Market Committee such reports as the committee deems necessary to obtain information as to compliance with the law and otherwise to enable it to carry out its functions. False reports would be subject to criminal penalties.

Regulations.—The Open Market Committee would be given power to prescribe regulations to effectuate the law and prevent evasions, as well as authority to define terms. Administrative functions could be performed by officers or representatives of the committee; and the Federal Reserve banks and other Federal or State agencies which are available could be used in the administration of the law.

A BILL To provide for special reserves to be held by banks and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Federal Reserve Act is hereby amended by inserting therein immediately following section 19 thereof a new section reading as follows:

"SEC. 19A. (a) Effective date and time limit: This section shall become effective on the first day of the third calendar month following the month in which it is enacted (except that percentages and other regulations hereunder may be prescribed in advance of the effective date to take effect on or after such date) and shall expire at the end of three years after its effective date.

"(b) Purposes: As a result of necessary war financing, the banks of the country own large amounts of short-term Government securities. Substantial amounts of such securities have already been converted into bank reserves and large additional amounts can be converted into such reserves with resulting multiple increases in bank credit and in deposits that serve as money. Such monetary and credit expansion, at a time when total effective demand for goods and services is in excess of the supply which can be produced by the Nation's productive capacity and labor force, would further aggravate inflationary pressures on prices and thus produce burdens upon and dislocations in interstate and foreign commerce and the Nation's monetary, banking and credit structure. Efforts to avoid such consequences through the use of methods of credit control available under existing law are seriously handicapped because, with the present large volume of the public debt, they would tend to produce such declines in the prices of Government securities (and securities in general) as to cause disturbances to the Government credit, interstate and foreign commerce, and the Nation's monetary, banking, and credit structure.

"The purposes of this section, in the light of which its provisions shall be construed and applied, are to require banks to hold short-term Government securities or other specified liquid assets in such amounts as may be necessary to protect interstate and foreign commerce and the Nation's monetary, banking, and credit structure from the above-mentioned burdens, disturbances, and dislocations.

"(c) Holding of 'Special reserve assets': (1) Every bank shall own 'special reserve assets,' as described in subsection (d) hereof, in an amount equal to the sum of such percentage of its demand deposits and such percentage of its time deposits as the Federal Open Market Committee (created by section 12A of this

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Act and hereinafter called the 'Committee') may by regulation prescribe from time to time as necessary to accomplish the purposes of this section, but in no event shall the percentage so prescribed with respect to demand deposits exceed 25 per centum or the percentage so prescribed with respect to time deposits exceed 10 per centum.

"(2) The Committee shall not initially prescribe a percentage in excess of 10 per centum with respect to demand deposits or in excess of 4 per centum with respect to time deposits and shall not thereafter at any one time increase such percentages by more than 5 percentage points in the case of demand deposits or by more than 2 percentage points in the case of time deposits. No initial percentage or subsequent increase thereof shall become effective until the expiration of a period of at least 60 days after notice thereof shall have been published in the Federal Register; but no other notice or procedure shall be required in connection with the prescribing or any percentage under this subsection notwithstanding any other provision of law.

"(3) In prescribing any percentages under this subsection, the Committee shall consider among other factors (A) the volume and ownership of securities and other assets eligible for holding as special reserve assets or readily convertible into such special reserve assets, (B) gold movements, currency fluctuations, and other factors affecting the available supply of bank reserves, (C) conditions in the Government securities market, and (D) the general credit situation of the country.

"(d) Description of 'special reserve assets': 'Special reserve assets' shall consist of any one or more of the following assets:

"(1) Obligations of the United States in the form of Treasury bills, certificates of indebtedness, and notes having a maturity not exceeding two years at the time of issue.

"(2) The aggregate amount of the following assets which a bank owns in excess of the sum of 20 per centum of its demand deposits and 6 per centum of its time deposits: (A) Coin and currency in its vault or on hand, (B) demand deposits due from other banks to the extent that they exceed demand deposits due to other banks, (C) deposits with a Federal Reserve bank (and the Reserve banks are authorized to receive such deposits from any bank), and (D) cash items received in the ordinary course of business which are in process of collection and are payable immediately upon presentation in the United States.

"(e) Computations: For the purpose of determining the amounts and percentages specified in subsections (c) and (d) of this section, each bank shall compute all such amounts on an average daily basis covering monthly computation periods or such other computation periods, not shorter than weekly periods, as the Committee may prescribe; and the Committee may prescribe different computation periods for different classes of banks, classified according to size or location or other reasonable basis. The amount by which the average daily amount of special reserve assets owned by a bank in any computation period falls below the amount required by this section or regulations pursuant thereto shall be considered a 'deficiency' for such computation period.

"(f) Penalty for deficiencies: Any bank having in any computation period a 'deficiency' as defined in subsection (e) of this section shall pay to the United States a penalty at the rate of one-half of 1 per centum per month upon the amount of such deficiency for such period. If such penalty is not paid to the Treasurer of the United States by the end of the month succeeding that in which such computation period ended, such penalty, together with interest thereon at the rate of 6 per centum per annum from the end of such succeeding month until paid, may be sued for and recovered by the United States in a suit to be brought by the United States district attorney in the district court of the United States of the judicial district in which the principal place of business of such bank in the United States is located, and the district courts of the United States shall have jurisdiction of such suits. If and when the Committee shall so request, it shall be the duty of the several district attorneys in their respective districts, under the supervision of the Attorney General, to institute proceedings to collect such penalties including interest. In unusual cases, when a bank has a deficiency which results from excusable error made in good faith, a certificate may be issued in the discretion of the Committee excusing such bank from payment of a penalty on account of such deficiency.

"(g) Reports: The Committee may require banks to furnish from time to time such reports and other information as it may prescribe, but no such reports or information shall be required except such as the Committee may find to be necessary to obtain information as to compliance with this section or otherwise to enable it to carry out its functions under this section. Any person who shall knowingly make any false statement or report or give any false information or

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willfully fail to furnish any report or information required under this subsection shall be guilty of a misdemeanor, and upon conviction shall be fined not more than $5,000, or imprisoned not more than 1 year or both; and the expiration of the provisions of this section shall not prevent prosecution for any such offense committed prior to such expiration.

"(h) Regulations and administration: The Committee may from time to time prescribe, amend, or revoke regulations to effectuate the provisions of this section or to prevent evasion or circumvention of its purposes either by abnormal accumulations of deposits due to or from other banks or by other devices; and such regulations may, among other things, include definitions of the terms used in this section not inconsistent with the definitions contained herein or with the purposes of this section. Any fuction of the Committee under this section other than the prescribing of regulations and the determination of matters of general policy may be performed by such member, officer, or representative of the Committee as it may designate for the purpose; and in the administration of the section, the Committee may utilize the services of the Federal Reserve banks and any other agencies, Federal or State, which are available and appropriate.

"(i) Definitions: When used in this section, unless otherwise required by the context—

"(1) 'Person' means any individual, partnership, corporation, business trust, association, or other similar organization.

"(2) 'Bank' means any person having a place of business in any State or in the District of Columbia which is (A) a national bank, or (B) a person engaged in the business of receiving demand deposits and subject to supervision or examination by the State authority having supervision over banks (or by the Comptroller of the Currency in the case of the District of Columbia); but the Committee may by regulation exclude from such term persons which it deems not to be substantially engaged in the performance of functions customarily performed by banking institutions receiving demand deposits and also not to be within the scope of the purposes of this section.

"(3) The amount of any obligation of the United States in the form of a Treasury bill, certificate of indebtedness, or note means the amount of the book value thereof as determined in accordance with regulations of the Committee.

"(4) 'Demand deposit' and 'time deposit' have the meanings given such terms by regulations prescribed from time to time by the Board of Governors of the Federal Reserve System pursuant to section 19 of this Act.

"(5) 'Month' and 'monthly' refer to calendar month."

A BILL To regulate consumer credit, to protect interstate and foreign commerce, to protect the monetary, banking and credit structure of the Nation, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Federal Reserve Act is amended by adding the following new section 20A between sections 20 and 21 thereof:

"SECTION 20A. CONSUMER CREDIT

"(a) Purposes of section: For the reasons hereinafter enumerated and in the light of which this section shall be interpreted and applied, the use of installment credit is affected with a national public interest which makes it necessary to provide for appropriate regulation of such credit:

"Installment credit is an important factor in financing the purchase of large volumes of goods, particularly consumers' durable goods, that move through the channels of interstate commerce. The terms and conditions on which installment credit is available have a direct and important effect on changes in the amount of such credit and consequently on the volume and timing of demand for, and flow in interstate commerce of, not only consumers' durable goods and related components and manufacturing equipment but also goods in general.

"Because of the inherent nature of installment credit and the purposes for which it is largely used, (1) such credit has a dangerous tendency, if unregulated, to expand unduly in certain periods and, in consequence, to contract unduly at other periods, and (2) such overexpansion and overcontraction are of material importance in initiating and intensifying excessive fluctuations and dislocations in national levels of purchasing power, prices, credit, and interstate commerce.

"Both directly and through their impact on interstate commerce and the national economy, such excessive or untimely fluctuations in installment credit

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interfere with the maintenance of high and stable levels of production and employment, burden interstate and foreign commerce, interfere with the power of Congress to regulate the value of money, threaten the stability of the Nation's monetary, banking, and credit structure, hamper the Federal Reserve System in maintaining sound credit conditions, and are important contributing causes to emergencies which put the Federal Government to great expense and burden the national credit.

"The purposes of this section are to provide appropriate regulation of installment credit and thereby to prevent, so far as practicable by this means, excessive or untimely fluctuations of such credit and the resulting national dangers and burdens mentioned above.

"(b) Definitions: For the purposes of this section, unless the context otherwise requires, the following terms shall have the following meanings, but the Board of Governors of the Federal Reserve System (hereinafter called the Board) may in its regulations give such terms more restricted meanings, and may define technical, trade, and accounting terms insofar as such definitions are not inconsistent with the provisions of this section:

"(1) 'Installment credit' means credit which the obligor undertakes to repay in two or more payments, or as to which he undertakes to make two or more payments or deposits usable to liquidate the credit, or which has a similar purpose or effect: *Provided, however,* That it shall not include (i) any credit to finance or refinance the construction or purchase of an entire residential building or other entire structure, (ii) any credit extended to a business enterprise to finance the purchase of goods for resale, or (iii) any other credit extended to a business or agricultural enterprise for any business or agricultural purpose unless the credit is secured by or is for the purpose of purchasing or carrying consumers' durable goods.

"(2) 'Credit' means any loan, advance, or discount; any installment purchase or conditional sale contract; any sale of property or services or contract of such sale, either for present or future delivery, under which part or all of the price is payable subsequent to the making of such sale or contract; any rental-purchase contract, or any contract for the bailment or leasing of property under which the bailee or lessee has the option of becoming the owner thereof, obligates himself to pay as compensation a sum substantially equivalent to or in excess of the value thereof, or has the right to have all or part of the payments required by such contract applied to the purchase price of such property or similar property; any option, demand, lien, pledge or similar claim against, or for the delivery of, property or money; any purchase, discount, or other acquisition of, or any credit upon the security of, any obligation or claim arising out of any of the foregoing; and any transaction or series of transactions having a similar purpose or effect.

"(3) 'Person' means any individual, partnership, association, business trust, corporation, or unincorporated organization; and, except that the criminal penalties shall not be applicable thereto, it includes the United States, any State or subdivision thereof, and any agency of one or more such authorities.

"(c) Regulations: The Board of Governors of the Federal Reserve System is authorized from time to time by regulation to prescribe maximum maturities, minimum down payments, maximum loan values, and amounts and intervals of payments, for such kind or kinds of installment credit as it may in the judgment of the Board be necessary to regulate in order to prevent or reduce excessive or untimely use of or fluctuations in such credit. Such regulations may classify transactions and may apply different maximum maturities, minimum down payments, maximum loan values, or amounts and intervals of payments thereto. Such regulations may contain such administrative provisions as in the judgment of the Board are reasonably necessary in order to effectuate the purposes of this section or to prevent evasions thereof.

"In prescribing such regulations the Board shall consider, among other factors, (1) the level and trend of installment credit and the various kinds thereof, (2) the effect of fluctuations in such credit upon (i) the purchasing power of consumers and (ii) the demand for and the production of consumers' durable and other goods which move in interstate commerce, and (3) the need in the national economy for the maintenance of sound credit conditions.

"(d) Compliance: No person engaged in the business of extending or maintaining installment credit, or of refinancing, purchasing, selling, discounting, or lending on, any obligation arising out of any such credit, shall extend or maintain any credit, or renew, revise, consolidate, refinance, purchase, sell, discount, or lend on, any obligation, in contravention of any regulation prescribed by the Board pursuant to this section. Every person engaged in such business shall

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keep such records or documents in such form, and make such reports, as the Board may by regulation require.

"(e) Penalties: Any person who willfully violates any provision of this section or any regulation thereunder the observance of which is required under the terms of this section shall be deemed guilty of a misdemeanor and upon conviction thereof shall be fined not more than $5,000, or imprisoned not more than one year, or both; but no person shall be subject to imprisonment under this section for the violation of any regulation if he proves that he had no actual knowledge of such regulation.

"(f) Investigations, court orders: (1) The Board is authorized to make such investigations as it deems necessary in order to aid in the prescribing of regulations under this section or in order to determine whether any person has violated or is about to violate any provision of this section or any regulation thereunder, and may require or permit any person to file with it a statement in writing, under oath or otherwise as the Board shall determine, as to all the facts and circumstances concerning the matter to be investigated.

"(2) For the purpose of any investigation or other proceeding under this section, any member of the Board, or any representative thereof designated by it, is empowered to administer oaths and affirmations, subpena witnesses, compel their attendance, take evidence, and require the production of any books, records, or other papers which are relevant or material to the inquiry. Such attendance of witnesses and the production of any such papers may be required from any place in any State or in any Territory or other place subject to the jurisdiction of the United States at any designated place where such a hearing is being held or investigation is being made.

"(3) In case of refusal to obey a subpena issued to, or contumacy by, any person, the Board may invoke the aid of any court of the United States within the jurisdiction of which such investigation is carried on, or where such person resides or carries on business, in requiring the attendance and testimony of witnesses and the production of books, records, or other papers. And such court may issue an order requiring such person to appear before the Board or member or officer designated by the Board, there to produce records, if so ordered, or to give testimony touching the matter under investigation or in question; and any failure to obey such order of the court may be punished by such court as a contempt thereof. All process in any such case may be served in the judicial district whereof such person is an inhabitant or wherever he may be found. No person shall be excused from attending and testifying or from producing books, records, or other papers in obedience to a subpena issued under the authority of this section on the ground that the testimony or evidence, documentary or otherwise, required of him may tend to incriminate him or subject him to a penalty or forefeiture; but no individual shall be prosecuted or subject to any penalty or forfeiture for or on account of any transaction, matter, or thing concerning which he is compelled to testify or produce evidence, documentary or otherwise, after having claimed his privilege against self-incrimination, except that such individual so testifying shall not be exempt from prosecution and punishment for perjury committed in so testifying. Any person who without just cause shall fail or refuse to attend and testify or to answer any lawful inquiry or to produce books, records, or other papers in obedience to the subpena of the Board, if in his or its power so to do, shall be guilty of a misdemeanor and upon conviction shall be subject to a fine of not more than $1,000 or to imprisonment for a term of not more than one year, or both.

"(4) Whenever in the judgment of the Board any person has engaged or is about to engage in any acts or practices which constitute or will constitute a violation of any provision of this section or of any regulation thereunder, the Board may make application to the proper district court of the United States, or the United States courts of any Territory or other place subject to the jurisdiction of the United States, for an order enjoining such acts or practices, or for an order enforcing compliance with such provision, and upon a showing by the Board that such person has engaged or is about to engage in any such acts or practices a permanent or temporary injunction, restraining order, or other order shall be granted without bond.

"(5) The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of offenses and violations under this section or the regulations thereunder, and of all actions to enjoin any violation of this section or the regulations thereunder or to enforce any duty created under this section. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any action to enjoin any violation of this section

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or regulations thereunder or to enforce any duty created under this section may be brought in any district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended (U. S. C., title 28, secs. 225 and 347).

"(g) Administration: In administering this section, the Board may act through its duly designated representatives and may utilize the services of the Federal Reserve banks and any other agencies, Federal or State, which are available and appropriate. The Board shall include in its annual report to the Congress such information, date, and recommendations as it may deem advisable with regard to matters within its jurisdiction under this section."

JOINT RESOLUTION To provide for the regulation of consumer credit for a temporary period

Resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That in order to protect the Nation's monetary, banking, and credit structure, and interstate and foreign commerce, against increased inflationary pressures, the Board of Governors of the Federal Reserve System is authorized, up to and including ——— to exercise consumer-credit controls in accordance with and to carry out the purposes of Executive Order Numbered 8843 (August 9, 1941) insofar as it relates to installment credit; and no such consumer-credit controls shall be exercised after such date except in time of war which begins after the date of enactment of this joint resolution or any national emergency which is declared by the President after such date of enactment. All the present provisions of sections 21 and 27 of the Securities Exchange Act of 1934 as amended (relating to investigations, injunctions, jurisdiction, and other matters) shall be as fully applicable with respect to the exercise by the Board of Governors of consumer-credit controls as they are now applicable with respect to the exercise by the Securities and Exchange Commission of its functions under that Act, and the Board shall have the same powers in the exercise of such consumer-credit controls as the Commission now has under the said sections.

SEC. 2. Public Law 386, Eightieth Congress (terminating consumer-credit controls after November 1, 1947), is hereby repealed.

Full Consumer Credit Bill Preferable to Joint Resolution or Shorter Bill Merely Reviving Executive Order

A comprehensive bill fully and explicitly authorizing consumer credit controls, somewhat along the lines of a draft prepared by the Board of Governors several months ago, is much preferable to a joint resolution or a brief form of bill which would merely authorize the Board to reinstitute consumer credit controls pursuant to the terms of Executive Order 8843 which was issued in August 1941. A comprehensive bill would not require more than a few pages.

The Executive order, and the statute under which it was issued, are sorely lacking in appropriate enforcement provisions. They contain only criminal penalties and authority to suspend licenses. Both penalties are so drastic that it is difficult to apply them in actual practice. Accordingly, they tend to make enforcement either too lax or unduly severe. To provide enforcement that is both equitable and effective, it is essential that there be specific provision for courts of equity to aid enforcement through their power to enforce subpenas and enjoin violations. That is a sound type of enforcement machinery that Congress has adopted in connection with other Government agencies.

A general provision giving the Board of Governors authority to obtain such aid from the courts in connection with all of its functions would be desirable. Such a provision, however, is especially needed in connection with the exercise of consumer credit controls.

Six years of experience with consumer credit controls under the Executive order have also shown the need for other changes in the underlying authority. For one thing, the statute should now prescribe clearer and more appropriate standards or guides to be followed by the Board in prescribing its regulations on this subject. In addition, it should place clearer and more precise limits on the Board's authority. The Executive order covers all consumer credit, whether or

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not it is installment credit. Experience has shown that present purposes can be served by a somewhat narrower statute applying only to the installment portion of consumer credit, and it is desirable that the Board's authority be so limited.

In addition, it is most desirable to have explicit and precise authority from Congress contained in one legislative enactment. If Congress should merely revive the Executive order, it would be necessary, in considering the scope of the authority granted, to look at at least three basic documents—the Trading With the Enemy Act on which the Executive order was based, the Executive order itself, and the action of Congress in reviving the Executive order. This is not merely a matter of inconvenience for the persons affected by consumer credit controls but makes for uncertainty as to the exact scope of the authority granted and just what provisions are applicable.

For the reasons stated, a comprehensive bill is preferable. Even if Congress should decide not to enact permanent legislation but to make it effective only for a limited period, such a bill could be utilized with a limitation as to time included. If, however, Congress should determine to reject the idea of a comprehensive bill on this subject and to enact merely a joint resolution or very brief bill, it is most important that any such brief enactment include authority for subpenas and injunctions with the aid of the courts. If necessary, this authority could be given in a one-sentence provision through the incorporation by reference of provisions on this subject already applicable to other agencies.

The CHAIRMAN. The committee will adjourn.

(Whereupon, at 12 noon, the committee adjourned.)

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