3804 Greystone Avenue
New York 63, N Y
November 28, 1947

Mr Marriner S Eccles, Chairman
Board of Governors of
The Federal Reserve System
Washington, D C

Dear Mr Eccles;

Some thoughtful economists feel that, with business loans currently at a high level, a depression may be touched off by a contraction of bank credit. For the last year and a half, the stock market has failed dismally to provide industry with the equity money it needs and would like to have. In order to continue at the present high rate of industrial activity, Lionel Edie has said that industry must raise 6½ to 7 billions "on the outside" for the next 5 years. At the moment, bank loans appear to be the major source of needed capital funds.

This is why I was bewildered to read, the other day, that you propose the banks increase the liquid reserves they are required to keep - additional reserves of 25% on demand deposits and 10% on time deposits.

Send copy of statement

I note that as of Dec.31, 1939 of total bank investments, 44% were loans, 37% were governments, and 19% other investments; that as of Dec. 31 last year 27% were loans, 66% were governments, and 9% other investments.

From your remarks, I can draw only two conclusions: either (1) that you regard the current high level of capital formation as gratuitous and not rooted in necessity; or (2) that in your office you are more worried about what may happen to the government bond market than by what may happen to U.S. industrial enterprise if bank credit for productive purposes is withheld. Would you set me straight about this?

Sincerely yours,

James P Rich

December 5, 1947.

Mr. James P. Rich,
3804 Greystone Avenue,
New York 63, New York.

Dear Mr. Rich:

Your letter of November 28 raises very far-reaching questions which are difficult to deal with in a letter. I assume that your comment was prompted by fragmentary accounts of my recent testimony and for that reason I enclose a copy of the full text, which should lead you to very different conclusions from the ones you have drawn.

However, I was not specifically discussing the important question of capital formation and its adequacy. I have given a good deal of thought to this matter and to the contention that business should finance itself more through capital markets and less through bank credit. In either case, however, to the extent that bank credit is expanded inflationary pressures on the demand side of the equation are intensified in view of continuing shortages of labor and materials. It cannot, therefore, be reasonably contended that such financing will call forth new production.

As for equity versus bank financing, I have concluded from considerable inquiry into the matter that business is disposed to borrow from the banks because bank credit is readily available at relatively low interest rates and the interest cost can be charged off on corporate tax returns; whereas, equity financing involves considerable expense and dilutes equity ownership in corporations. As for the actual volume of capital formation that, of course, gets into tax problems and estimates of what may be needed in the future rather than under present conditions.

Sincerely yours,

M. S. Eccles,
Chairman.

Enclosure

ET:b