22 WILLIAM STREET
NEW YORK

December 12, 1938

Honorable Marriner Eccles, Chairman,
The Board of Governors of the Federal Reserve System,
Washington, D. C.

Dear Mr. Eccles:

I thought you would not mind if I dropped you a line to tell you how much I enjoyed your remarks at the Forum dinner last week. If you will permit me to say so, I felt that you handled a difficult situation exceedingly well, and the reaction among your audience was very favorable.

I happen to be in close touch with the committee who made the arrangements for the dinner and I know that they greatly regretted the fact that your speech was given under somewhat of a handicap, in that the previous speaker had taken far too much time and had caused a waning of the listeners' interest. That was regrettable, and I only hope that it did not disturb you.

In your talk you laid great stress upon the importance of the profit motive in our capitalistic system. With that point I agree heartily. Shortly, thereafter, however, you indicated that you felt that at the present time the government is doing almost everything it can to encourage the profit motive. That is a point with which I am inclined to disagree, because it has seemed to me that for a considerable period of time the government's tax policies, the government's attitude toward labor and the government's general hostility toward the making of profits, actually constitute factors highly discouraging to entrepreneurial activity.

There is another point which I should very much like to discuss with you. While I am definitely an advocate of low interest rates, and while I have no fault to find with a 2-1/2% rate for long term government money, and a 3% rate for long term corporate money, nevertheless, it seems to me that a zero rate for short term money is over-doing the matter. I say that for this reason:

To me the differential between the yield on money (either currency money or deposit money) and the yield on short term securities of comparable integrity, is a highly important factor. For if money yields about the same as comparable short term obligations, then there is no incentive to the conservative holder of large amounts of money to invest it in short term obligations. He, therefore, tends to utilize money, which is supposed to be the medium of exchange, as a medium of investment, and he thereby depletes the amount of money which can actually circulate.

At the present time I should say that the differential, rather than working in the direction of inducing a conservative person to utilize other forms of obligations as his medium of conservative investment, actually acts as an inducement, to the conservative person, to hold money as a short term medium of investment. For, if we consider that money is the sum of currency outstanding in the hands of the public, plus total commercial bank deposits, namely about $45,000,000,000. then the return on this money, as a whole, can be considered as the interest paid by all commercial banks on time deposits. From that point of view, the interest return on money, as a whole, can be evaluated at about $230,000,000. per annum, which, if applied to a volume of $45,000,000,000.

of money suggests an over-all average rate of about .5% per annum. And this rate is available to the holder of money at a time when government bills, which, it seems to me are properly symptomatic of the truest short term interest rate on securities, yield only .02%.

We have, then, a situation where the differential between the yield on money and the yield on highest grade short term obligations favors the holding of money. The reverse of this should, it seems to me, be true: We should have a situation where short term obligations of the highest grade yield perhaps a 1/2 of 1% or 1% per annum more than can be obtained by holding money.

Just how this situation could be brought about, I do not know; but there are two devices which I can suggest, the first of which, unfortunately, is somewhat unorthodox:

> First; If the government would utilize the existing short term rate for its new financing and its refunding operations it seems to me probable that the short term rate might slowly be built up to around one-half of 1% to 3/4 of 1% without necessarily affecting the long term rate, and without, I believe, really putting the government in a dangerous situation due to a preponderance of short term debt.
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> Second: If the monetary control authorities would do everything in their power to induce commercial banks to cut down the interest that they pay on time deposits the over-all average yield on money could be greatly reduced underneath the figure that now obtains.

I do not say that this suggestion, or these devices, will answer the monetary problem, but I have felt, for a considerable period of time, that steps in these directions would probably result, first, in a lesser incentive to hold the medium of exchange as a medium of investment; second, in a better distribution of money, and third, since money constitutes immediate purchasing power, in a better distribution of purchasing power throughout the country.

I do hope that you may find time to give frank consideration to this thought. If you would care to comment upon it I can assure you that any comments that you might make, either upon this thought or upon any other subject, would be treated with the utmost confidence.

I greatly enjoyed the opportunity of meeting you a week ago, and I hope that I may have a similar pleasure some time in the future.

Very respectfully yours,

Stephen M. Foster

Stephen M. Foster.

December 17, 1938.

Mr. Stephen M. Foster,
22 William Street,
New York City.

Dear Mr. Foster:

Your letter of December 12th is very much appreciated. Members of the committee who made arrangements for the dinner were very gracious about the difficulties that arose entirely beyond their control, and I assured them that my only regrets were that I had not presented what is, at best, a difficult subject more effectively. I had prepared a text principally because in so doing there is less likelihood of misquotation in the press. However, I prefer to speak without a manuscript.

I am enclosing a copy of this text which you might be interested to see because I think it will serve to clear up one or two points that you raise in your letter. For instance, I did not mean to convey the impression that I felt government is doing all it can to encourage private activity.

I was much interested in what you had to say about the differential between the yield on money and the yield on the highest grade short term obligations, favoring the holding of money. I agree with you that this is entirely undesirable and was one of the considerations that lay behind the increasing of reserve requirements early in 1937, when apart from putting the System in a position where it could use open-market operations either up or down as occasion required, it was hoped that there could be some firming of the short term rate that would bring it more into line with longer term rates without at the same time materially disturbing the latter. Of course, the volume of reserves now is such as to be beyond control, and your suggestions are certainly worthy of careful consideration.

It was a pleasure to have an opportunity to see you in New York, and I particularly want to thank you for your letter.

Sincerely yours,

M. S. Eccles,
Chairman.

enclosure

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