TENTATIVE DRAFT - CONFIDENTIAL

Contains revisions of L. Currie p. 48

"GOVERNMENT SECURITIES OUTLOOK" EXPLORED AT SECOND CONFERENCE

Invaluable Facts Revealed in Discussion
Sponsored by Journal 2/26/40

Second in the series of conferences scheduled under sponsorship of the Savings Bank Journal was the round table discussion devoted to an exploration of the Government Securities Outlook, held at the Metropolitan Club in Washington, D. C. on Monday, February 26, with 28 representative authorities present, prepared to answer frank, basic questions asked by Earl B. Schwulst, first vice-president, Bowery Savings Bank, New York, who acted as moderator.

As was true in the first conference, held the previous month, dealing with the railroad situation, this "meeting of minds" concentrated upon an agenda drawn up to cover every phase of the "Government Securities" subject, with the assistance of Messrs. Schwulst, Gilmartin, Dr. Burgess (vice-chairman of the National City Bank of New York); Mr. Massie (vice-president, The New York Trust Company); Mr. Garner (vice-president, Guaranty Trust Company), Messrs. Parker and Harrison, resulted in the throwing of much light on important factors and conditions, pertaining not only to the present but future status of things.

While the opinions were widely divided, in many instances, ranging from highs of optimism to new lows of pessimism, the consensus of views as summarzied from a neutral position, cause many controversial points, heretofore unclarified, to stand out in bold relief.

Any attempt to interpret them in this account of the conference would tend to distort or to color. But presenting a report of the discussion, with highlights of comments as actually delivered, enables every reader to analyze and draw his own conclusions on the basis of facts, figures and views expressed.

Getting under way at 5:15 p.m. with Mr. Schwulst serving admirably as moderator, the conference continued until 11:05 p.m., with all conferees entering freely into the discussion and remaining three-quarters of an hour after the agenda was completed to voice further opinions and clarify, realistically, additional angles raised.

Three Divisions of Subject

The conference attempted to approach the discussion from the standpoint of the interest of holders of Government bonds and divided the subject into three parts:

1. The future price of their holdings, which is the same as saying the future course of money rates.
2. The marketability of their holdings.
3. The preservation of the purchasing power of the principal invested in the bonds and in the interest income derived therefrom.

Under the heading of the "price of bonds or the future course of interest rates", "excess reserves" was considered very fully. The gold question was freely discussed, as well as the fiscal policy of the Government, the expansion of commercial loans and improvement in general business, the marketability of Government bonds with general questions relating thereto, and the intrinsic value of Government bonds.

Colonel Leonard P. Ayres, who had intended to be present at the conference, was held in Cleveland and thus submitted answers to certain questions in the agenda. Moderator Schwulst opened the conference with a description of factual material contained in charts which are reproduced in this issue of the Journal in the order as presented.

Description of Charts

CHART NUMBER ONE (page ___)- Compares changes in the central gold reserves of the United States, France, England and the Netherlands and shows graphically the extent to which the United States has accumulated gold, particularly since the devaluation of the dollar in early 1934.

Mr. O'Connor added to the facts under this chart a reason he had found for the provision in the Gold Act of 1934 wherein the value of silver in relation to gold was established at one to three, or until the monetary price of silver rose to $1.29. The reason he believed he had discovered was that from 1900 to 1929 the ratio of the value of World's silver production to World gold production, was one to three.

Mr. O'Connor gave further facts that in the nine years from 1930 to 1938, the ratio of World silver and gold production changed to one of silver to 8.5 of gold. The five years from 1934 to 1938 since the passage of the Act, this ratio was one to 9.7 and in 1938 the ratio reached one to 11.3.

Mr. O'Connor also stated that, according to the Director of the Mint, as of the end of 1938, the Netherlands and Switzerland had larger per capita holdings of gold than the United States, these figures being:

United States	-	$111.00	per capita
Netherlands	-	114.00	" "
Switzerland	-	166.00	" "

Additional figures on gold were given in the course of the discussion.

CHART NUMBER TWO (page __) - Presents weekly changes in the volume of money in circulation from 1934 to date, as well as a comparison with the year 1928.

CHART NUMBER THREE (page __) - Shows weekly changes in required and excess reserves of member banks. The sharp fluctuations in required reserves which occurred in late 1938, early 1937 and early 1938, reflect the various changes in reserve requirements that were placed into effect during this period.

CHART NUMBER FOUR (page __) - Shows the effect that changes in the volume of outstanding public debt have upon the relative yields at which such debt can be sold.

It will be noted that during the years 1925-30, inclusive, when the Federal debt was declining and state and municipal debt increasing, the United States Treasury $4\frac{1}{4}$s, 1947-52, sold on a lower yield basis than the New York

State Canal and Terminal 4s, 1946, a prime obligation. Conversely, in the years 1934-39 inclusive, when Federal debt was rising rapidly and the volume of state and municipal debt remained virtually unchanged, the New York State Canal and Terminal 4s commanded a lower yield than the Treasury $4\frac{1}{4}$s.

It should be observed in connection with the present status of the Federal debt, that the Second Liberty Bond Act, as amended, provides that the face amount of bonds, certificates of indebtedness, treasury bills and treasury notes issued under authority of that Act, "shall not exceed in the aggregate, $45,000,000,000 outstanding at any one time."

A recent press release on the subject of statutory debt limitation shows the present debt to be $42,109,751,669 as of January 31, 1940. This figure is classified as gross public debt but the facts seem otherwise as the chart indicates for 1940 it would appear by deducting the reported gross public debt as of January 31, 1940, from the debt limit of $45,000,000,000, that there would be remaining $2,890,248,331 but this reported debt does not take into consideration the amount of Government guaranteed debt. On December 31, 1939, this guaranteed debt amounted to $5,734,879,091. Adding this debt to the reported gross United States debt as of January 31, 1940 of $42,109,751,669, gives a total real gross United States debt of $47,844,630,750, or $2,844,630,-750 in excess of the statutory debt limitation.

CHART NUMBER FIVE (page __) - Was presented by Harold G. Parker, vice-president of Standard Statistics Co., Inc., at the stage of the discussion which related to probable market action of Government bonds. It summarizes, in chart form, his opinion as to the yield bases on Governments below which various types of investors might cease to buy the different issues and also assuming that a reaction in prices was experienced, the yield bases, which might be counted upon to revive investor interest.

When this chart was presented, a Government representative pointed out that the assumption that Social Security funds would not be invested at rates below three per cent, was incorrect. An amendment passed by Congress in 1939 permits the Secretary of the Treasury to buy for these funds, United States obligations in the open market at his discretion.

A Ballot Is Taken

As the discussion proceeded, Moderator Schwulst distributed a ballot to each of the conferees, asking them to fill out the answer to the two questions and then return the ballot to him, without any signature. This ballot is reproduced herewith:

BALLOT

(1) By the end of 1940, I think the U. S. Treasury 2 3/4s due December 15, 1965 and callable on December 15, 1960, and which now yield approximately 2.35 per cent, will sell at prices to yield approximately ....per cent.

(2) If I were a prophet, I should prophesy that there will be no material change in the level of interest rates as measured by the yield on long term U. S. Government bonds for a period of at least........ This assumes that the United States will not be drawn into the war.

The analysis of the answers was revealing.

Question Number One: "By the end of 1940, I think the U. S. Treasury 2 3/4s due December 15, 1965 and callable on December 15, 1960, and which now yield approximately 2.35 per cent, will sell at prices to yield approximately ....per cent", showed in a tabulation of answers that, for the moment, we certainly have a free and open market for U. S. Government bonds.

Four of the conferees felt that there would be no change from the arbitrary level (2.35 per cent) stated on the ballot, while 11 felt that the yield at the end of 1940 would probably be higher, and nine felt that the yield would be lower.

However, when the vote was analyzed further, it was found that the four who set 2.35 per cent, were probably men who were not particularly familiar with daily market prices, because at the date of voting, the yield on this particular issue was 2.39 per cent.

Including in the group those who contemplate little or no change, those who indicated that prices would not be more than approximately 10 bases points away from the then market, it was revealed that 10 of the conferees expected that the market would be substantially the same at the end of the year as it was at the date of the meeting.

Eight of those present felt that by the end of the year this particular issue of U. S. Government bonds would be selling at new peak prices; two of the eight suggested that the yield would be two per cent, or a price of approximately 112.10.

Of the six who were bearishly inclined, only two expected to see this issue of bonds selling below par and the most bearish forecast was a yield of 2.90 per cent, which was followed by another of 2.80 per cent, one of par, two guesses of 2.65 per cent, and one of 2.61 per cent.

The spread between the opinions of more than 12 points is interesting, but what is even more interesting to holders is that no single expert, no matter how bearish, made a guess that Government bonds would be selling at the end of this year below the market prices established shortly after the outbreak of the war in 1939.

Question Number Two, "If I were a prophet, I should prophesy that there will be no material change in the level of interest rates as measured by the yield on long term U. S. Government bonds for a period of at least ...... This assumes that the United States will not be drawn into the war."

This second question was amended by the Moderator to define the limits which were to be generally understood as constituting a "material change in the level of interest rates" as something greater than 50 bases points.

The answers to this question were almost as varied as were those to the first question. One conferee said "two days"; another "not long;" 10 set the limit of their feeling of assurance within 12 months, five suggested two years; three made a guess of from three to four years; one felt sufficient assurance with regard to the situation to prophesy another 20 years. Two of the conferees turned in blanks on this question.

As might be expected, the expert who estimated that the yield on the 2 3/4s would be 2.90 per cent, was the man who guessed two days as the time limit within which we might allow for a material change in the level of interest rates.

The two conferees who felt that the 2 3/4s would be selling at 112, in one case expected that there would be no change for a year, and in the other case for two years. The expert who guessed 20 years used a 2.15 per cent basis for his forecast of the price of the 2 3/4s at the end of 1940.

While there was a very wide degree of opinion held by these experts, certainly as a group, they did not believe that an investor should at this time so adjust his investment policies as to allow for a decline in Government bond prices any greater than occurred during 1939.

Gifford Springs Surprise

Toward the end of the evening, Congressman Gifford of Massachusetts, who is a member of the House Banking and Currency Committee, stood up and pointed his finger in what appeared to be an accusing manner at Governor Eccles, stating: "If I may make a parting shot about your debt, Governor, I have a little ditty that I give to my audiences after talking the matter over seriously and on a high plane. Remember this, won't you? --

"Hush, little deficit, don't you cry,
You'll be a crisis, bye and bye!"

The tenseness of the apparent encounter was promptly broken!

Free Discussion Period

After the discussion of the agenda had been completed, the conferees spent considerable time in free discussion. The questions asked and answered during this period further clarified some uncertainties. One of the questions asked by the Moderator was "Are the banks' supervisory authorities, in the event of a decline in Government bonds, likely to permit banking institutions and insurance companies to carry Government bonds at so-called conventional values? Is this sound?"

Governor Eccles answered this question: "I see no reason why there should be any change in the present examination arrangement. I have been very much in favor of not following what I please to call the 'ticker tape' with reference to sound investment. That had a good deal to do with bringing about the present rulings. We know, as a matter of practice of experience, that in time of crises we must modify, as we did in 1932 and 1933, the conventional methods that were in effect at that time. No bank can get into difficulties as a result of depreciation in their Government bond portfolio unless they are forced to sell it." Whereupon the Moderator questioned: "To meet their liability?" To which the Governor responded: "To meet their liability at a time when it has greatly depreciated below their cost, institutions are permitted to borrow at par from the Reserve System, so if they are a member bank there would be no occasion for selling Government bonds at a loss."

The Moderator then asked: "And you see nothing that would make the Federal Reserve change its ideas with respect to lending?" To which Mr. Eccles replied: "I see no reason for that and, personally, I think it would be sound policy to continue to do so. The banks got into difficulties not as a result of Government bond portfolio, or as a result of a portfolio of high grade investments; the banks got into difficulties as a result of speculative investments, collateral loans, unsound business and mortgage loans, and not as a result of this type of investment."

Mr. Goldsmith proceeded with: "I am sure Governor Eccles did not have a very easy time formulating the present rules for bank examination. If I remember correctly, it took about a month or five weeks. The head of one of these examination agencies assured all and sundry when the market declined substantially as a result of the increase in reserve requirements, that all banks should write down their losses in Governments which they had brought down to par immediately instead of amortizing them and it took about four weeks before new regulations came out which did not make it necessary for them to write them down immediately."

Mr. Goldsmith wondered: "if in a change of administration at Washington with a new group of people in office, whether those regulations would hold, or whether they would not?" Whereupon Governor Eccles remarked "of course, the period you mention was prior to the three agencies getting together." And Mr. Goldsmith stated "I was just saying how difficult it was for the three agencies to get together on those regulations and how long it took."

The Governor then answered: "Naturally, when you take examiners who have followed a certain practice for a good many years, it is always difficult to bring about a change and as to what may be done in the future it seems to me it is difficult, of course, to say whether or not they would forget the past experience and want to undertake to follow a market which in times of depression is really not a market.

What I mean is, when there is a large quantity of either Governments or other securities that we know are unavailable in times of great depreciation we should look at intrinsic values rather than quoted values. I think the experience of the past so far as bank examiners and bankers are concerned, is such that they are not going to go back to the unrealistic approach to the examination procedure that was in effect at the time of the last banking crisis."

Mr. Goldsmith then said "Mr. Eccles has stated, and I think it is the general view here, that it would be far more desirable if more Government securities were sold to actual bona fide savers and investors, rather than to commercial banks." With which Mr. Eccles concurred.

Banks and Government Bonds

Mr. Goldsmith followed, "I think Governor Eccles will agree that to the extent the deficit is invested with commercial banks, we have an inflationary tendency. The Federal Reserve Board has very forcibly, I believe, requested Congress to study the possibility of giving it more power to reduce excess reserves It seems to me there is a conflict there that the

Government has the power to maintain Governments at high prices, but I question whether many people in the Government consider that it would be desirable to use these powers to maintain Governments at high prices and I would like to ask Mr. Eccles whether he does not think that somewhat higher rates on Governments might facilitate the process that he thinks is advisable and that is the transfer of the part of the securities from commercial banks to bona fide investors."

Mr. Eccles responded: "I think the opposite. I am basing what I say partly on what has been stated here by bankers that if interest rates were higher there would be possibly a greater tendency to take Government bonds. One of the reasons that banks today are hesitating to take Government bonds is because of the low rate. With a higher rate, the demand would not only be greater on the part of the individual investors, but it would likewise be greater on the part of the banks, and therefore it would be possible to maintain a higher rate based upon a demand."

Mr. Goldsmith suggested: "Unless you took the excess reserves out of the way" and Mr. Eccles said "of course, if you took the excess reserves out of the way then, naturally, the banks would not be a factor in the field or would not be investing in Government bonds, and interest rates thus would likely go somewhat higher."

Intrinsic Value of Government Bonds

The first part of the free discussion, after the agenda had been completed, explored more fully this question of accepting the intrinsic value of Government bonds at par regardless of the probable effect of an impairment of capital by taking market values for the purpose of examination. Also, what would the effect be should an institution continue a dividend policy if Governments materially declined in value?

Mr. Lanston opened this part of the conference: "We have discussed the outlook of Government securities from the standpoint of money as well as the supply and demand for securities. We have discussed the possible reluctance of banks to further expand deposits and hence have discussed the deposit - capital ratios. There has been some slight mention of loan and investment capital ratios, but I think we have missed the real point and I would like to know the opinion of others on it. It seems to me the real point upon which institutional, commercial bank activities, and Governmental activities will depend, is the result of the risk that those assets bear to capital, not in terms of soundness today, but in terms of slight changes in market prices and the ratio at which that risk bears to each year's income.

"For example, the banking system might have capital funds or a capital account of about $6,000,000,000. Roughly, $4,000,000,000 of that are paid-in capital. Two billions are reserves, surplus, and all other capital accounts. Various estimates by the Treasury and others have been made to show that if, for any reason, easy money remained, but the average level of bond prices was reduced five points on long term bonds that it would work out in the banking system as a whole to $100,000,000 a point.

"In other words, five points down would mean $500,000,000 nicked into bank reserves, not reserves after book if the institution had to take the loss. The danger is in such market conditions existing for longer than a temporary period. I have run into this question in any number of places, that from the point of view of capital soundness there is no question but banks are interested in earnings and they are interested in them from the point of view of dividends.

"If a bank has been paying out 50 per cent of net in dividends with a book profit, will it, as a conservative institution, feel willing or able to continue to pay out 50 per cent of the net if they have a paper loss measured in terms of market, or will the examiners permit them to do so? In other words, there is a limitation on capital, or there is a limitation to the degree in which banks can expand their investment account in terms of capital and in terms of earnings, not in terms of excess or deposit - capital ratio.

"The point has been made that there is no market for commercial loans and that generally in the past the loans were much shorter in character than they are today and that such loans were measured more in terms of quality than in changes of interest rates. Investments were longer and had a greater vulnerability to interest rates. I want to know, do others feel that this is the real limitation on bank investments?"

Mr. Goldsmith also put into Mr. Lanston's question: "What will the bank examining authorities do about permitting banks to pay dividends when, according to market on Government securities, the capital is somewhat impaired?"

Mr. Eccles countered: "The examining authorities do not control dividends" and Mr. Lanston stated: "May they make recommendations when they consider them unwise?" To which Mr. Eccles said: "Yes, they may make recommendations, but a good bank should not need them. It usually knows without recommendations having to be made."

The Moderator then said: "Well you think, therefore, Governor, that if there were a substantial market depreciation in the Government bond portfolio that the holding bank ought to be somewhat more conservative in its dividend policy than it might otherwise be, irrespective of how it might regard those bonds intrinsically?"

To which the Governor stated: "I think that would depend entirely, of course, upon its assets other than Governments and upon its capital structure. Some banks follow a conservative dividend policy; but banks are no different than any other type of business. Many businesses have to curtail or reduce dividends. That is no calamity!"

Benson on "Dividends"

Mr. Benson stated: "Would it not be a pretty serious thing for a bank board to declare dividends if capital were impaired? Would it not be illegal? And would it not subject bank directors to personal liability if they paid dividends at a time when the market value of their Government holdings declined to a point where there was an impairment of capital?"

Mr. Eccles countered: "No, it would not. I say this for the very reason that the only impairment is one of the capital structure itself and on the recapitulation of the bank examination forms you will find on the last page of the recap where any depreciation in Government bonds or in the four higher grades of securities is not taken into account at all in determining the sound capital structure. Thus, no impairment would be found or written in by a bank examiner because of a market depreciation either of Government securities or any of the four higher rated securities. Even the lower-rated securities are taken on a basis of their average over an 18 months period rather than the market upon the particular day of the examination."

Mr. Benson then remarked: "We had a case in New York where bank officers were held liable or charged with taking deposits when the bank was insolvent. I mean taking deposits, not paying dividends, but accepting deposits when they were technically insolvent." To which Mr. Eccles stated: "That is correct. There were plenty of banks which were in that situation during the depression, but that was not due to their Government bond holdings or their holdings of the four higher rated securities."

Effects of Depreciation

Mr. Lanston then asked: "Is it conservative to ignore depreciation of the market if it should occur in the four higher grade securities?"

Mr. Eccles: "I think it would be very unsound to do otherwise.

We had an experience of what it did to the banking system. If that helped the economy, I fail to see wherein by destroying confidence in the banks due to a depression situation you either help the depositors, the stockholders, or the public."

Mr. Goldsmith asked: "Your high grade bonds, Mr. Eccles, could sell off very sharply, not because of a depression, but because of prosperity. Do I understand you correctly to say that you believe a bank would be justified to continue its dividend schedule even though its capital, or a substantial amount of it, was impaired by a decline in the market in high grade securities?"

Mr. Eccles: "It would depend entirely on other factors. It would depend upon its capital ratios and upon its other investments. If it was due purely to Government bonds, I would say 'yes', or if it was due to the four higher rated securities, I would say 'yes'. So long as the banks are amortizing bond premiums out of current earnings before paying dividends over the life of the securities, it would be sound policy."

Mr. Ihlefeld said: "Governor, is it not a fact that the viewpoint you express is shared in by the Federal Deposit Insurance Corporation and by the State Bank Supervisors through the agreement they arrived at in 1938? In other words, all supervisory authorities have concurred in that viewpoint on the treatment of Federal bonds and high grade securities."

Mr. Eccles agreed but he did "not know to what extent such treatment was shared by the examiners. It is concurred in by all the authorities."

Mr. Goldsmith then said: "I think there is some valid question as to whether the officers of the Comptroller of Currency would take the same position on dividends that Mr. Eccles takes right now."

Eccles "Under Fire"

At this point the Moderator endeavored to direct questions to someone other than "this veteran soldier, Governor Eccles, who has been considerate and generous in bearing practically the brunt of all the questions and answers" but Mr. Holton would have none of it and after some laughter Mr. Eccles remarked "this is like being before a Committee of Congress."

But Mr. Holton said he had a rather easy question to ask: "In support of a decline in a Government market, would it not be just as well to stop a break by pushing the market down rapidly; for example, by two or three points? Would this not have a tendency to stop the selling?"

The Governor informed Mr. Holton "that is pretty well what was done in September. If you will refer to the record in that month, the market for the longer bonds got up to around the high point of 109 and as war became more and more imminent the market worked down and the Reserve System did not at first enter the market at all. At the time the Reserve System entered the market it had already declined two points from its high point. The Federal Reserve did not enter the market until the day that war was actually declared. During that time there was an avalanche of orders.

"The Reserve System certainly did not want to be in a position of under-writing profits of the banking system in the Government bond account of over $1,000,000,000 merely for the purpose of having the banks come in at some later date expecting the Reserve System to sell the bonds to them at a billion dollars less than they had previously sold them. Consequently, the Reserve System permitted the market to drop about a point a day for the first two or three days. During that period there was only one day when the System purchased over one hundred million dollars of securities.

"As the market began to get lower, the pressure for selling was less. When the selling had almost dried up, the Reserve System withdrew from the market for a period of a day or two. Then, the market broke again.

The minute the Reserve System again went back into the market, the market came back. The instant it was known that the System was in the market, it came back with a bound and the System was unable to purchase any securities. As a matter of fact, they purchased less than $1,500,000 worth of securities on a market rebound of more than half a point.

"To show that the market was very thin so far as selling was concerned, I may say that when the banks thought they could sell, there was very little selling; the minute the banks thought the Reserve was in the market and propaganda was spread that the market was going to decline much lower, there were many who thought they could still sell and then buy at a lower price.

"However, as soon as the Reserve System entered the market again, they did not want to sell because they had very little profit left. As long as there is a substantial profit in the market, certainly the Reserve System should move away from the market very rapidly but the question of how fast they should move away depends on conditions surrounding the market at the time and also upon the volume of selling as well as where the selling is coming from."

Dr. Currie on "Inflation"

Dr. Currie had been an interested observer throughout the discussion on the agenda. During the period of free discussion, Moderator Schwulst asked him if he had anything to say or any question he would like to ask about the matters contained in the agenda.

Dr. Currie remarked: "There is one point on which I might make one or two observations which apparently worries some of you a good deal. It is a matter on which I happen to have done much work and that is the subject of inflation. There is a great deal of work being carried on in Government departments. Much of it has not as yet been published. There has been published, however, the result of research on capital expenditure, housing expenditure, consumer debt and foreign loans as well as net government expenditures. It has all been related to what would be necessary to bring about inflation.

"Of course, it depends considerably on how much is saved at different levels of income. The savings you take were drawn from the stream of income, - part of the price of goods, - part of the price of production and capital investment that just equals the savings, - just restores it.

"From various studies that have been made in recent years, it appears that throughout the 1920s we saved somewhere around 19 or 20 per cent of the gross national income, - that is the income before a deduction for depreciation. I will not go into the matter deeply but there is a great deal of reason to think that this basic savings pattern has not been modified as a result of the New Deal.

"In 1937, with a $70,000,000,000 national income, we reached 17.18%, I think, in basic savings. This would seem to indicate that when we reach toward $85,000,000,000 or $90,000,000,000 national income per annum, we probably need something like $19,000,000,000 or $20,000,000,000 of gross capital investment each year, - capital investment net and capital investment for replacements to offset depreciation accounts. Now that is a huge sum.

"In the 1920s, we got up to about $16,000,000,000 per annum. I think you need not really fear inflation in this country until your capital exceeds that level and we do not see it now. Canvassing every durable goods field of necessary capital expenditures and making generous estimates such as $900,000,000 a year for utilities; $900,000,000 a year for railroads; $4,000,000,000 a year for residential housing, - figures of that magnitude - in all of it we can only add up to $15,000,000,000."

Sale of Government Bonds

Mr. Goldsmith asked Dr. Currie whether he thought "It makes any difference if the Governments are sold for such commercial program, as Dr. Currie suggested, or whether they are sold to banks or private investment from a commercial point of view?"

Dr. Currie answered: "I am trying to put it in different terms. Most of the discussion tonight has proceeded on terms of the mechanics, quantity of money versus the quantity of goods. I was trying to put it in a different way; viz., money for outlets of capital investment. If savings were less and consumption higher than the national income, then the fifteen billion dollars total investment would correspond to the total employment. That is what happened in England.

"The percentage of savings now as contrasted with the great war has been cut in half, so the given dollar of capital expenditure could support a much higher level of national income than it did before. Therefore, under the present pattern of savings, as far as we can see, it will be necessary to find outlets for investment, for capital expenditure, housing expenditure, consumer debt, foreign loans, and net government expenditure, probably in excess of $19,000,000,000 or $20,000,000,000, before you begin to worry too much about inflation."

Mr. O'Connor then interposed: "Mr. Moderator, in that connection, I recall a study in England that took 20 percent of the national income per year as necessary for investment in order to keep the machine going and make substantial progress. You remember that, Dr. Goldenweiser? Mr. Young's study indicated that in this country the same percentage would be required. This is a very interesting point that Dr. Currie describes. He has put it a bit differently, but I simply desire to give the other measurement as a sidelight on what he says."

Dr. Currie then said: "The bridge between the mechanics and the monetary theory is the rate of interest. Hence you must force your rates of interest down low enough. For example, there is presumably a lot more capital investment that would be profitable at a two percent rate of interest than at four percent. That is the way monetary theory proceeds. I am not sure but in part the demand would come from residential building. I think possibly in the railroads, utilities, mining and manufacturing and such fields, probably the rate of interest has very little effect.

"There are other considerations which seem to be much more important than a rise in the rate. We think that housing is still rather important. The contrast a person at present can make between the purchase of a new home and the rent he is paying, finds that the rate of interest is important; but, apart from that, economists do not contribute nearly so much importance to the rate of interest as they have in the past. Nevertheless, the interest rate is the main bridge between the money supply and capital investment."

Eccles on "Savings and Spending Theory"

Governor Eccles then at length discussed the savings and spending theory as a fundamental issue. He said: "In the first place, possibly if we did not have government bonds in which to invest at this stage of our economy, we would have no savings funds. If you will recall, there is always a contraction of the total debt structure in a period of deflation. Deflation is a contraction of credit, not only of bank credit, but of credit generally.

"From 1929, which was in an inflationary period, so far as employment and the price level were concerned, we had a contraction of something like $40,000,000,000 of the total debt structure. During that contraction of the debt, the savings banks, trustees and other investors generally had no trouble in investing their savings funds, because such funds were likewise contracting.

"With respect to the Government's deficit, we have created employment, have created funds through the banking system, we have been creating savings so that those savings and the process of buying Government bonds with such savings, are putting the savings bank into the income stream where they are now. This flow of savings came when the contraction of the total debt throughout the country had stopped. If such a process continued, there would be no problem about savings. The problem you have at present is in the investments you have made in the past.

"Taking the economy as a whole, there is an excess of savings. Otherwise, it w ould not be necessary to place savings funds into Government bonds or Baby Bonds. There would not be such a huge existing supply of idle funds which have been created and now belong to corporations or banks which are seeking investment. Therefore, if you desire to get a higher rate, if you desire to avoid a purchase of Government bonds for savings, it seems to me that it is necessary for these savings to get out into the capital market, into the private investment field to the extent that Dr. Currie has indicated."

Market Demand of Savings

The Moderator then remarked that the market must demand the savings. Whereupon Governor Eccles said: "That is correct. Why doesn't the market demand those funds itself? It is not because of the interest rates and it is certainly not because the terms are unfavorable. Mr. O'Connor would say, it is because of Government deterrents. I have not yet been able to detect the extent to which the deterrents are responsible for the low amount of private investment. Yet, I am connected with many business enterprises and know something about practical business problems. No business is turning dow n orders today. There is no problem of production in any field. There is nothing anyone wants that they are not able to buy. There is the willingness on the part of those who have funds, possibly to buy consumer goods to some extent.

"On the other hand, there is an inability on the part of a great many others to buy what they would be willing to purchase if they had the purchasing power. So, it seems to me there is something valid in this question of over savings in the corporate sense, as well as that of the individual, because they are unable to put their funds into productive use on account of the inability to find markets sufficiently to secure an outlet for the large amount of savings. I do not believe that a Government deterrent is responsible for all that.

"I think there is something much more fundamental in the System. In my opinion, this fundamental thing is the way in which the national income is divided between consuming buying power on the one hand and savings on the other - meaning that part of the national income which Dr. Currie has indicated is available for new investment.

Social Security Program Considered a Factor

"I believe this present administration has contributed through a Social Security program to that problem. However, this program has not given the aged an assurance that they have a pension of an adequate and reasonable amount; it has not given the assurance of employment; so when we talk about confidence, we are thinking of confidence as a cause, when as a matter of fact confidence is an effect.

"The masses of people when they get employment do not forget the periods of unemployment. A great many of them say, which, individually is a fine thing, it is splendid for everyone to be out of debt and have a rainy day reserve. The result of the depression has been so severe that it has made corporations and individuals generally feel that what they want to do is get out of debt, to have a rainy day reserve to take care of their old age and take care of the possibility of unemployment.

"Now, such a point of view was excellent during the time when we were a debtor nation and when we had a rapidly increasing population. It was fine when other economic factors than the present ones existed, but I think that fundamentally this problem will not be solved until, in my opinion, we recognize a new approach to it.

Figures on Plant and Equipment Expenditures

"I just received some figures today that are very illuminating on this question: these statistics relate to the amount of expenditure for plant and equipment in the United States from 1921 to 1939. From 1921 to 1930, the expenditures were about $8,000,000,000. Of that amount, $1,639,000,000 was financed through new security issues. In other words, 20 per cent was financed by going to the markets through new offerings. The financing data was taken from Moody's. The information on expenditures for plant and equipment account are the estimates compiled by the Federal Reserve Board.

"From 1931 to 1939, the expenditures on plant and equipment amounted to $4,773,000,000. The average annual offering of new securities during this period was $322,000,000, or 6.7 per cent. This is evidence of the extent to which business is not depending at all upon capital markets. It is depending upon its own earnings and its own depreciation reserves, which it is plowing back.

"The best example is that of 1937, which was a year when the expenditures on capital outlays was about equal to the average of the expenditures from 1931 to 1933. Whereas, with the same capital expenditures from 1930 to 1931, business went to the capital market for $1,600,000,000, amounting to about 1/5 of the total expenditures. During 1937, business went to the capital markets for $__________. When capital expenditures approached the present depression level, new flotations provided approximately eight per cent of the expenditures as compared with 20 per cent in the 1920s.

"I merely refer to that so as to indicate to you what Government financing does through the banks in creating funds and how the principle of everybody getting out of debt and building rainy day reserves applies to business generally. Its determination to do its own financing and not go to the capital markets is the true situation. Hence, institutions such as savings banks, insurance companies and trustees, if they did not have Government securities in which to invest, I do not know what would take their places.

On Shift of Investments

"In the 1920s, there was an investment of about $9,000,000,000 a year in municipals. For the last several years there has been no increase in municipal securities. If a shift is desired from Governments into municipals, it makes very little difference. It does not help the situation - both are public debt. Furthermore, you could not possibly invest in municipals for they are not available in any great degree.

"Many individuals desire to invest in foreign securities. Many have speculated in that direction. The query is, do you want to invest in municipals or in foreign loans or in stock market inflationary operations? Of course, you do not. You want to invest in sound business development.

"I pointed out to you that eight billion dollars was invested in plant and eq uipment during the 1920s. That does not cover the utilities at all. It covers facilities outside, apart from that. You have no opportunity to invest in such securities today because if you studied the balance sheets of the corporations, you would ascertain that they do not have to go to the capital markets and there is no immediate prospect of the situation changing. Now that, after all, is the nub of the problem.

"You talk about Government bonds and interest rates and excess reserves, but the real fundamental issue is, Mr. O'Connor thinks, that if we get a conservative government in Washington, confidence will be restored, Government will reduce taxes, Government expenditures will be reduced. Mr. O'Connor says, 'we will get these expenditures down to less than seven billions even to six and one-half billions of dollars. Then privatecapital will not have funds to invest in governments because the budget will be balanced and we will all go out on a splurge of confidence, we will employ all the people who had jobs in 1929, plus 6,000,000 more, which is the increase in the number of employable people, and will employ enough to overcome technological unemployment created since 1929.' I just do not think it is possible. As a business man, I wish I did."

Mr. Parker then offered the following: "It seems to me that the Federal Reserve's present power to reduce required reserves against bank deposits was the missing linkin the early 30's, that has since been provided. In other words, if we could have provided banks with reserves at the time they were being drawn on so heavily, they would not have had to dump their securities and thus create a very bad crisis."

Dr. Goldenweiser then responded: "I think the flexibility of reserve and the flexibility in the eligibility requirements, the ability to get help from Federal Reserve banks on all assets that are sound rather than only on a very s elected and rapidly shrinking list, are very important factors of safety."

BREAKDOWN OF AGENDA

1. The Price of Bonds or the future Course of Interest Rates.

A. Excess Reserves:

The first question under this heading was: 1. Over the near term prospect of, say, the next 12 months, is there any likelihood of a substantial reduction in excess reserves as a result of: (a) Gold exports? (b) Increase in reserve requirements? (c) Free use of gold? (d) Expansion in the currency? (e) Substantial increase in bank loans? (f) Additional government borrowing: (g) The opening up of the capital market for "new money" borrowing? (h) Sales or maturities of Government securities held by Federal Reserve banks?

Dr. Goldenweiser was requested to answer this question. He said that there would be no gold exports; it would be very unlikely that there would be an increase in reserve requirements; it would be very unlikely that there would be a free use of gold; there would be expansion in the currency to a limited extent but not sufficient to make a difference; that a substantial increase in bank loans would not make any inroads on reserves that would amount to anything; that additional government borrowing would not likely be large, if any, in the next year; and that the opening up of the capital markets for "new money" borrowing is not very likely; that sales of Government securities held by Federal Reserve banks is a matter of policy... it would be hard to predict but it is not likely that there would be sales enough to make a big difference in the reserves. Of course, Dr. Goldenweiser's answers were predicted on the point of view that the European War will continue and that the United States will not become a party to it.

The second question propounded by Moderator Schwulst was: 2. Over the near term prospects of, say, the next 12 months, is there any likelihood of a substantial increase in excess reserves as a result of: (a) The release of gold from earmark? (b) Further gold shipments from abroad? (c) Decline in bank loans? (d) Decline in circulation? (e) Decrease in commercial bank bond holdings through sales to the Federal Reserve Bank or to other purchases?

Dr. Goldenweiser answered: "There are likely to be very substantial amounts of gold released from earmark; there are likely to be very considerable imports of gold; there is not likely to be a decline in bank loans; there is not at all likely to be a decline incirculation; whether there is going to be a decrease in commercial bank bond holdings, through sales to the Federal Reserve Banks, is unlikely in the present circumstances."

Problem of Reserve Requirements

The Moderator then asked: "At the present time, the reserve requirements of member banks are between 12 and 22 3/4 per cent. Are these requirements likely to be increased during the next 12 months?"

Governor Eccles answered: "The power to increase reserve requirements is very limited. It is possible to increase reserve requirements by about one-seventh of the present requirements, thus making an increase equal to the original reserve requirements. I can see no purpose to be accomplished by such an increase with the amount of excess reserves as excessive as they are now."

The Moderator then asked: "Do you think it likely that Congress may broaden the authority of the Federal Reserve system to increase the reserve requirements beyond the limits that they may now be increased?"

To which Mr. Eccles said: "I do not think it is likely during this year...I could not predict as to the future."

Colonel Ayres submitted a similar opinion that "it is improbable that the reserve requirements of member banks will be increased during the next 12 months."

The following question was then asked: "Through the sale of Government securities, the Federal Reserve Bank could reduce reserves by $2,477,000,000. If these bonds were all bought by member banks, excess reserves would then be reduced by a similar amount; if bought by others than member banks and paid for with deposits in member banks, excess reserves would be reduced by the amount so purchased less the reserves required on these deposits, which would be somewhere between 12 and 22-3/4 per cent. Do you think that over the next year the System will attempt to raise money rates through the sale of Government securities?"

Governor Eccles stated: "I do not think that over the next year the amount of the sale of Government securities by the Federal Reserve System would be a factor in its influence on interest rates."

Mr. Goldsmith stated: "The Federal Reserve has been selling securities when the market is strong but they certainly are not selling them at the present time."

Dr. Stonier thought that "over the next year the System would not attempt to raise money rates through the sale of Government securities."

The Moderator then asked: "To what extent are excess reserves reaching a level where they a re losing their potency as a bond market factor? Are the reserves growing in the case of individual banks to the point where the banks simply will not invest them?"

To the first part of this question, Mr. Parker answered: "It is apparently having an increasing effect in this direction." As to the second part of the question: "There are more and more individual banks which are reaching the point where they do not want to further invest in Governments," Mr. Ball agreed with Mr. Parker.

The Moderator then asked the next question: "If it is true that further increases in excess reserves are losing their potency, and if it is true that banks will not invest such further increases, to what extent is this due to the fact that banks may be carrying large bank and foreign deposits against which they may feel they should be reserved substantially 100 per cent? To what degree is it due to the declining capital-deposit ratio or other pertinent ratios?"

Mr. Goldsmith answered this question: "I think it is true that the office of the Comptroller of the Currency has been pressing banks recently, which have a poor capital ratio, to put up more capital. They have done that in some cases where the banks are in a highly liquid condition. The Comptroller's office has taken the position that there was no assurance the banks were in a highly liquid condition and they should put up more capital. I think if such a situation continues, it will have an adverse effect on markets."

Dr. Goldenweiser offered: "As to the capital-deposit ratio, I do not know. My opinion is, however, that it ought not to be a matter to be considered in this connection at all; but whether or not it is, I have no information. With relation to the 100 per cent reserve against foreign deposits, I think that it would exist almost entirely in New York, since the excess reserves in New York are enormous. I doubt very much whether that is a consideration."

Excess Reserve Situation

The next question asked by the Moderator was: "In your judgment, is the price of bonds so high that even a slight tendency of excess reserves to fall would give rise to psychological or panicky selling of bonds by institutions and other holders desiring to 'beat the other fellow to the trough'?"

Mr. Devine did not think it would and said: "I do not think that everyone would immediately run out. It might take some time and would depend largely upon the action of the market at the start, but I really do not think there would be any rush to get out of the securities, because excess reserves are so huge that a slight decrease in them certainly would not have much effect on money."

Mr. Schwulst suggested that "we had quite a drop after the declaration of war in September and excess reserves fell then." Mr. Devine answered: "Was that not caused by a panic stricken people because of the war...that wasn't really caused by any commercial demand or anything of that kind."

The Moderator then suggested: "I think the inference to be drawn from the question is that when banks see excess reserves starting to contract, then they say - 'Well, here, boys, this is happening, we had better start to get out and make some profits.'"

Mr. Devine then said: "You had a pretty good example in 1937. In the Fall of that year, when excess reserve requirements were increased, short term issues went off first and long term bonds later on. However, now with excess reserves two or three times as great as they were then, I doubt very much whether the decline of one or two billion dollars worth of excess reserves would create a panic in the Government securities market."

At this point, Mr. Morss said: "I should think that if reserves went off a billion or two, we would have to look the situation over in order to determine whether or not there might be a further excess reserve reduction. If it seems to be temporary, I believe the market would be somewhat lowered for a time; but if it seemed that it was setting up a tendency which would persist, I would expect the market would be off rather sharply because it is now so thin."

Mr. Lanston stated: "I think it depends entirely upon the reasons for a change in the trend of excess reserves in dollar amount. Such a change would have very little bearing, because if you had a price level of $2\frac{1}{2}$ points higher last June with excess reserves a billion lower, that would be material, because the change in the level of excess reserves would be the dominating factor. This idea of 'beating the other fellow to the trough' has been such a losing game in the last four years, that I think most people are giving it up."

What Is Determining Factor?

Mr. Benson was asked: "Would the result be anything more than temporary - that is to say, might we not expect a rebound upward in the market?" He answered: "Yes. It seems to me that if we would analyze the causes of the decline that indicated a change in the investment policies of the banks and a revival of business, it would be shown that bonds were perhaps on a downward trend and yields upward due to changes in investment; but unless it is from some other temporary cause, the rebound would be very quick."

The Moderator asked the next question: "Will excess reserves have to be practically totally exhausted before we arrive at a position where we might say that we are definitely headed for higher money rates and lower bond prices?"

Governor Eccles answered: "I do not think excess reserves are entirely the determining factor. One must consider the possibility of a long range position of interest rates. Of course, the excess reserves effect banks so far as their investment and credit policies are concerned. I think that interest rates are influenced by the supply of funds in the hands of investors in relationship to the opportunity for investment of the funds. That is a very important factor with reference to interest rates as well as the question of excess reserves; and so long as uninvested savings are greatly in excess of the opportunity for investment, you will continue to have low interest rates."

Mr. Parker added: "I would say that so long as you have any excess reserves in reasonable quantity that you can hardly have an increase in money rates that is not simply a correction of the present rate. I mean normal rates that exist in certain short-charge categories. It would be quite possible to lend and borrow on the excess reserve fund and these borrowings would flow to whatever point they happened to be needed at the moment. This would interfere with all interest rates through the country."

Colonel Ayres offered the following comment: "If excess reserves were being rapidly decreased, interest rates would be moving upwards and bond prices downwards, before the excess reserves were entirely exhausted."

The Gold Question

Under this heading, the question was asked: "Would you say that as a practical matter, the Treasury will indefinitely buy all gold presented from whatever source, at $35.00 an ounce?"

Senator Townsend stated: " I think that if we continue to purchase gold at the present rate, by 1943 we will have all the gold in the world. We have 69 percent of it now."

The Moderator clarified the question: "Under the existing legislation, doesn't the Treasury have to take whatever steps may be necessary to maintain the parity between gold and the dollar at the ratio of $35.00 an ounce?"

Dr. Goldenweiser agreed and said: "I do not think the Treasury, under the present law, could refuse to buy any more gold. That would not in any way affect the parity between gold and the dollar. There would be nothing in stopping the purchase of gold that would make for disparity between the gold dollar and the paper dollar."

Senator Townsend asked: "Would the change of price stop the purchase of gold?"

Dr. Goldenweiser did not see how it would "because if the Treasury should pay more or pay less for gold, the currency would move with it so that the parity would continue. The Secretary of the Treasury would be discharging his responsibility by keeping gold on the parity. He is under an obligation to keep it on the basis of $35.00 an ounce so long as the President's proclamation of $35.00 an ounce is in effect."

Is There Foreseeable Limit In U. S. Purchase of Gold?

The second gold question was: "At the present time, this country holds $18,035,000,000 out of a total estimated world gold monetary stock of $26,000,000,000, or 69%. Since the devaluation of the dollar and the fixation of the price of gold at $35 an ounce, the net imports of gold have amounted to $11,120,820,000. In 1939, such net imports amounted to $3,574,151,000 and so far in 1940 have amounted to $383,370,000. In 1939, exclusive of Russia, the world production of gold amounted to over $1,200,000,000. It has increased since we established the gold price of $35 an ounce approximately $750,000,000 per year. Are there any foreseeable limits as to the amount of gold which the United States Treasury will purchase?"

Mr. Goldsmith stated: "We certainly are not going to buy any more than the other 30 percent plus current gold production. There are many people in Washington beginning to wonder whether it might not be more advisable to extend credits abroad than to take more gold. Perhaps this situation will become a leading topic of conversation, but it is not now."

Mr. O'Connor pointed out that there was a question about the accuracy of the ownership by the United States of sixty-nine percent of the world's gold, and believed that the percentage was probably around 62 per cent. Dr. Goldenweiser thought the figure slightly high -- that it was nearer 60 than 69 per cent.

Mr. Eccles clarified this by stating: "You have earmarked gold and stabilization gold, neither of which is in the monetary stock, so that with those two included, it may be 69 per cent. With them out of the calculation, the percentage would be close to 62 percent."

Commodity Price Level and Flow of Gold

The Moderator then asked the third question on gold: "Is it likely that a substantial rise in the commodity price level in the United States would tend to make gold flow from the United States rather than into it, or are there other factors, such as the need of warring nations for supplies and the general foreign unrest, which are likely to induce the continued flow of gold to this country, almost irrespective of the course of commodity prices?"

Dr. Goldenweiser answered: "I think that your question here includes part of the answer. In so far as purchases are made by the belligerents who have to buy goods at any cost, your rise in prices would not affect the amount of purchases that they make here except that they would come to the end of their rope a little sooner. But, in so far as we export commodities to South America and to other non-belligerents, I should imagine if we had a very substantial rise in prices, there would be less gold coming into this country, although it would continue to come."

The Moderator then asked: "In the light of past experience, is the Treasury likely to resort again to the sterilization of gold imports?"

Congressman Gifford thought not - "that it is high time the reverse process set in and let you and me have some gold."

Mr. Schwulst then asked: "Would such a course of action be advisable from the standpoint of our banking system?"

Mr. Eccles said: "It would be helpful to the banks, because what the banks would get through that process would be interest bearing securities in lieu of idle excess reserves. It would depend on the extent to which sterilization processes were undertaken. It could only be undertaken by the sale of securities to the banks. In other words, they would use their excess reserves for that purpose."

Possible Effect of
Sterilization Policy

Mr. Schwulst then asked Mr. Eccles: "From your position as one of the supervisory authorities of a very substantial part of the banking system and having your pulse on the commercial banking system as well as, if not better, than anyone else, - do you think there would be more of a feeling of reassurance in the minds of commercial bankers against inflationary tendencies if the Treasury should adopt the sterilization policy with respect to future gold imports in place of letting them continue to pile up excess reserves?"

Mr. Eccles replied: "Yes. I think banks would feel that if the excess reserves were pretty largely extinguished by whatever means, it would naturally cause them to feel that further expansion of the means of payment would be stopped or diminished, so far as the banking system is concerned."

Mr. Gifford then asked the Governor: "If the Treasury had the authority now to sterilize gold?"

Mr. Eccles answered: "The Government has the authority but only up to $45,000,000,000 at the present time, in which to increase its debt and thus its authority would be curtailed to that amount."

Dr. Goldenweiser clarified the discussion concerning the question of the Treasury sterilizing gold by stating: "I think that if the Treasury should sterilize the gold, the banks would never have assurance that they will not cease sterilizing or de-sterilizing; and for that reason I believe it would probably not give the banks any feeling of security. In addition, sterilization by the Treasury, which has a direct effect on the reserve position with the possibility of always changing the de-sterilization or re-sterilization, does have the effect, - which I think would not be desired, - of taking the management of the domestic money market out of the hands of the Federal Reserve authorities and putting it into the Treasury."

On Circulating Gold

Moderator Schwulst then asked the question: "Would it be advisable to circulate gold again within the country, and what would be the means of effectuating such a policy? What would be the result upon excess reserves and interest rates?"

Senator Townsend answered: "I think the circulation of gold would eventually reduce the price."

Mr. Goldsmith reflected some interesting views in Washington on this question and said: "A number of officials wonder who would take the gold in the first place, - who would be the 'suckers'. I think it is pretty generally the feeling here that the amount of gold which would actually go into circulation would be very small; that if the public wants gold, it would be at a time when the Federal Reserve System would not want to have the reserves reduced; if gold were available in large quantities, the public knowing that they could have it, would not take it, so the general feeling in Washington is that the distribution of gold would not help much."

Colonel Ayres stated: "In my opinion, it would be advisable to circulate gold again in this country. There are many different ways in which that could be done and it is not possible to say what the result would be on excess reserves or on interest rates without knowing beforehand which method of resumption is determined upon."

Resumption of Gold
Standard Considered

The Moderator asked the next question: "Are there any fears in your mind that the concentration of monetary gold in this country is likely to militate against the ultimate resumption of the gold standard internationally? What would be the means at our disposal of bringing about a redistribution of gold?"

Governor Eccles commented: "I think it is rather difficult to say to what extent the concentration of gold in this country is likely to militate against the ultimate resumption of the gold standard internationally. We recognize that most of the gold production is outside the United States. Of course, the British Empire would be interested in the use of gold internationally.

"To say what the world will look like after the outcome of the war is a very difficult thing to contemplate, but with reference to the means at our disposal for bringing about a redistribution of gold, it seems to me that we are pretty well limited in bringing it about except through the loaning of money or the taking of a very large quantity of goods from the rest of the world in excess of the goods which we sell to the rest of the world.

"In other words, we would completely have to reverse our position of having a favorable trade balance. It would be necessary to have an unfavorable balance on a large scale for quite a period of time. If we made gold loans to foreign countries, they would not be able to stay upon a gold standard even if they were put upon it, except as we were willing to take their goods. We would get the gold right back again if we continued to have a favorable trade balance."

Mr. Gifford said: "I want some 'hard' money in my pocket. I disagree with Mr. Eccles. The public wants that 'hard' money. Of course, they know it can be taken away from them again but many people would be very glad to hoard some of that 'hard' money." Mr. Gifford suggested that we take the pound sterling for the gold."

Mr. Eccles responded: "When you take the currency of another country, it is simply a loan without interest."

Colonel Ayres answered: I do not believe that the concentration of gold in this country will militate against the ultimate resumption of gold standards internationally. We cannot do very much toward bringing about a redistribution of gold internationally. The most effective factor making for such a redistribution would be an enlightened peace treaty terminating the war and encouraging international trade."

The Price of Gold

The Moderator then asked the next question on the Agenda: "Would it be inadvisable to take off the fixed price of $35 an ounce for gold or place an import duty upon gold? Would such action tend to curtail the importation of the metal into this country?"

Dr. Goldenweiser answered: "At the present time a reduction in the price of gold would mean primarily one thing; and that is, reducing the buying power of England and France in this country. Whether that is desirable or not depends on one's point of view. It would not for the present tend much to curtail the import of gold, but it would make the amount of gold, that is in this country already or that is available to belligerents, buy less of our goods."

Dr. Goldenweiser also stated: "Of course, the price of gold is always the same throughout the world. The ounce of gold will buy the number of pounds or the number of francs that will exchange for $35; and if you change that, then the price of different currencies would change correspondingly. Hence, the price of gold in terms of currencies, barring restrictions in movement, has got to be the same everywhere.

"If the price of gold were reduced here, the price of the dollar would go down on the foreign exchange by the corresponding amount. Commodity prices in this country would decline somewhat, but not as much as they would with uneconomic conditions. There are conditions whereby the decline in the price of gold would have an immediate and strong repercussion on prices; but in view of the situation in the world, it would have very much less of a repercussion. However, it would tend to depress our price."

The Doctor and Mr. Gifford had quite a discussion about placing the imports of gold on a quota basis, but Dr. Goldenweiser stated: "It would be impossible. Gold is a very movable commodity. It is the one commodity on which you could not effectually enforce a quota for different countries."

Mr. Gifford: "That is the exact answer, of course. We would like a quota on Russia but she would simply send it through other routes."

Dr. Goldenweiser: "The gold we get from Russia mostly comes from other countries. The original pre-war Russian gold mostly went to Sweden; then Sweden sent it to England; then England sent an equivalent amount of gold here and you could not identify it. We could not handle the gold import problem through a quota system."

Colonel Ayres had this to state with relation to the effect of an international redistribution of gold on world prices, on the dollar, and on our commodity prices: "It cannot be estimated without having available specifications with respect to the nature and amount of the redistribution, and these specifications cannot now be available."

On Stopping Gold Imports

Moderator Schwulst asked: "What means are there at our disposal of preventing the taking into our monetary system of further gold importations into the country?"

Dr. Goldenweiser answered: "Technically, we could just refuse to take it, but that would have consequences which we probably would not want to bring about. It would mean that our prices would very drastically decline and then it would mean that England and France would be deprived of a very large part of their buying power in this country. If the question is meant not legally but as a matter of policy, the only thing we could effectively do would be to repeal our tariffs, to stop our exports, - which we are not very likely to do - or to make very large foreign loans, which is not in the immediate future of probability."

Mr. O'Connor then asked: "Would you add acquisition of foreign securities?"

Dr. Goldenweiser: "That is a method of lending money."

Mr. O'Connor: "Foreign or American securities?"

Dr. Goldenweiser: "That is, pay our own debts rather than lend to others?"

Mr. O'Connor: "That is right."

Dr. Goldenweiser: "Yes, that is another way, but I do not know that there is very much of such securities available any longer."

Devaluation of Dollar

Moderator Schwulst then asked the next question: "What are the prospects for further devaluation of the dollar, and what would be the effect of such devaluation upon excess reserves and the interest rate level?"

Mr. Eccles did not personally think that there was any prospect for further devaluation, stating: "The effect of it, however, if it were undertaken, would be to increase excess reserves. As far as the interest rate level is concerned, I do not think it would have any appreciative effect upon the cause of the excess reserves at the present time. Deposits are already so excessive that a substantial increase in either one or both would have very little effect."

Foreign Deposits To Be Withdrawn In Gold

Moderator Schwulst brought out the desire of the conferees to clarify the amount of foreign bank deposits in this country that could be withdrawn in gold. Dr. Goldenweiser estimated the amount was about one and a half billion dollars. Mr. Eccles suggested that this figure should have deducted from it the amount of a reasonable working balance which would necessarily be maintained in the United States. He thought that the average balances so carried were somewhere around six hundred millions of dollars.

"You would have to assume," Mr. Eccles continued, "that as long as we were doing any international business that if the world were in a position where it is withdrawing gold from this country, resulting in the reduction of bank balances, very likely it would be during a time when the nations would require a substantial working balance here. In my opinion, about one and a quarter billions would be the maximum that would be withdrawn."

Mr. Lanston then remarked: "If it helps any, the report of the 101 Cities states that the bulk of the movable foreign deposit fund is $696,000,000.00."

Probable Public Reactions On Gold Circulation

The Moderator further requested information as to what the reaction of the public might be with respect to actually availing itself of the privilege of taking gold if it should be circulated again...would any considerable amount of the people avail themselves of such a privilege either in certificate or metal form and 'salt' it away so to speak.

Mr. Mills thought that a great deal of such gold would be hoarded not only by citizens of this country but also by foreigners. "Gold if available in the United States, I think, would be seized upon by people all over the world. A lot of it would disappear out of circulation," he said. He thought it would amount to between one-half and one billion dollars.

Dr. Goldenweiser stated that during the bank crisis in 1933, three hundred millions of gold was hoarded.

Mr. Goldsmith stated: "I should think all the people who could have hoarded gold in large quantities in recent years would have probably hoarded it in London because there the gold profit was never confiscated. I was wondering whether people who really wanted to hoard gold in quantity wouldn't really do so in some place other than the United States?"

Mr. Schwulst suggested: "Can't those people now buy gold with sterling and hoard it in London if they choose?"

Mr. Parker: "Couldn't it be hoarded by Germans if Germany should win the war? Do not these charts here show that England has no gold reserves any longer?"

Dr. Goldenweiser: "That isn't exactly right. The British equalization fund has taken over the gold of the Bank of England. The chart does not mean that England has no reserves...it only means that it does not publicize them. The Bank of England hasn't the reserves, the Government has them."

The Hoarding of Gold

Mr. Lanston: "There was a large number of bills of 50 dollars and over that have been hoarded, amounting to more than $300,000,000." He also thought that if gold were made available, there would be a fairly sizeable increase over the present amount of currency hoarded.

The Moderator asked Mr. O'Connor whether he would discriminate between a $50 silver certificate and a $50 gold certificate if both were bought in the open market.

To which Mr. O'Connor replied: "Yes. If we had more monetization of silver, there would be a greater demand psychologically for gold. I think, too, that given certain attitudes about the fiscal position of the government, the demand for gold might arise. I think it is incalculable. It isn't a question of a year or what you will, but the psychological attitude concerning the fiscal position of the government can change overnight; and thus there would be a demand for gold from all over the world as well as from individuals and banks in this country."

Mr. Eccles interposed: "Because of the dangers of inflation?"

Mr. O'Connor: "Anything you like. Psychologically, - the fear about debt."

Mr. Ball offered: "I think the hording might be quite considerable in amount. My reflection on that is, - the bank of which I am the president is in the small loan business, we find more customers who are willing to go into debt than those who are willing to put money in a savings account. I think the reason for that is the very great uncertainty about this gold question....that it is not understood by either the banker or the customer. Then there is uncertainty as to conditions abroad.

I think there is a growing attitude on the part of many people that 'well, let us have a good time while we can have it'; and thus I think they would have more confidence in gold certificates than they would in bank deposits and thus it would lead to increased hording."

Chart Showing Markets For Government Bonds

At this point, the Moderator requested Mr. Parker to submit a chart, that appears on page ? of this report, entitled: "Markets for Government Bonds". He said: "I submit this chart merely as my opinion as to the rates at which various groups or types of industrialists would be very reluctant to say the least to purchase bondsif the yields dropped below the stated levels that I have drawn in heavy black line.

"On the one to five-year bonds, individuals, benevolent societies, colleges, hospitals and small insurance companies would not buy such governments if they yielded less than 2%; small commercial banks and pension funds would not invest in less than 1½%; large insurance companies and savings banks would not support such government issues at less than 1½%; fire and casualty companies at less than 2%; and large commercial banks at less than 1%.

"On the five to ten-year maturities, the first two groups would not support the issue at less than 2½%; the small commercial banks and pension funds at less than 2%; the large insurance companies and savings banks at less than 2%; fire and casualty companies at less than 2½%; large commercial banks at less than 1-3/4%.

"And on maturities of over ten years, the first two groups or types of investors would not support government issues at less than 3%; the next two types would not support the issue at less than 2½%; large insurance companies and savings banks at less than 2½%; fire and casualty companies at less than 3%; and large commercial banks at less than 2½%.

"On the right side of the chart are the yields that should attract investor support ranging from 3% to 1½% for the one to five-year maturities; from 3¼% to 2¼% for the five to ten-year maturities; and 3½% to 2-3/4% for the maturities of over ten years.

"As I understand it, the Moderator is asking that you use these as a guide to your own views as to whether we are or are not on a non-economic level of interest rates."

As explained in the first part of this text, the chart indicates an incorrect basis for social security, but it was made clear during the discussion that the Secretary of the Treasury can nowgo into the market and buy governments at any yield.

Mr. Lanston stated; "It is more or less obligatory on the secretary's part to go into the open market with the funds available from social security whenever the market goes below the previous month's yield."

Governments Influencing of the Money Market

The question was asked: "What means are available to the Governments, between Treasury, Federal Reserve System and Governmental agencies to control or influence the money market?" To what extent can that control or influence be exercised? To what degree is there uniformity of action or coordination among these various bodies?"

Governor Eccles answered: "The Treasury is limited by the statutory debt limit of $45,000,000,000 in its ability to sterilize the existing excess reserves or what our incoming gold may add to it.

"On the other hand, the Treasury did increase excess reserves very materially by the use of the stabilization fund to pay Government expenses instead of borrowing. To that extent the deposits of the banks and the excess reserves would be increased to the degree that the Treasury used the silver profit,

The deposits in excess reserves could likewise be immediately increased by about $1,500,000,000 to the extent the Treasury used the power given it under the Thomas amendment to issue $3,000,000,000 of currency for the payment of expenses. Instead of borrowing, they could likewise increase deposits and excess reserves. Thusthe Treasury, on the inflationary side, has power to increase excess reserves and deposits about $6,500,000,000 without any further authority. The deflationary side is almost non-existent at the present time.

"The Federal Reserve has the power," continued Mr. Eccles, "to decrease excess reserves by the sale of existing portfolio, a little over $2,400,000,000. The Board also has the power to increase reserve requirements by one-seventh of the existing requirements. This would be about $1,000,000,000. In other words, the Board's power is limited to $3,000,000,000 or $3,500,000,000."

With relation to industries, Mr. Eccles said "the Treasury could reduce their balances with the Federal Reserve System which are running about eight hundred million. It could further reduce them to a working balance of around one hundred million and thus further increase excess reserves by such means. So, instead of $6,500,000,000, it would be over $7,000,000,000.

On the inflationary side, the power of the Reserve System is almost unlimited. It could decrease the reserve requirements by close to $3,000,000,000 which would add to excess reserves and not effect the deposits. Nevertheless, excess reserves would be increased by that amount.

The System could also go into the market and purchase Government securities to almost an unlimited amount and thereby increase excess reserves. Of course, they would purchase such accounts by credits, using all the gold to reserve against those accounts. Their limitations would be only to the extent that Government bonds held would cover 60% of reserve requirements. Gold would cover 40% of the requirements. Until the deposits, currency and circulation equalled 35% in one instance and 40% in the other; until they were down to that point with the gold coverage, they could continue to buy Government bonds because such bonds could make up the difference between the gold coverage and the 100% coverage."

Degree of Coordination Between Government Agencies

With respect to the coordination of the activities and policies of the Treasury and Federal Reserve, that is to what degree he thought there was uniformity of action or policy or coordination between the ideas of the two great agencies ofGovernment as they may affect excess reserves, money rates, etc., Mr. Eccles stated: "It depends entirely upon the issues. There have been differences, of course, with reference to policies,--that is a question of public knowledge. The question of coordination, of course, would be dependent entirely upon the possibilities of agreement as to policy. It is naturally like any situation where there is a divided authority. It resolves itself into questions of individual points of view.

"At the present time, the Treasury in its power with reference to purchase of silver, and other powers which I have enumerated, as I have stated before the Committees of Congress, has not a greater power in influencing the monetary policy than does the central banking system.

"The System's power is very, very small and limited. I have said that the central banking system as for some time been not much more, so far as its actual authority is concerned, than that of a glorified transit department."

To the question "In what way does the financing of governmental deficits affect the money market?", Dr. Goldenweiser responded; "So far as direct influence is concerned and in so far as Government securities are bought with bonds, the deficits increase deposits and absorb excesses because it serves to increase reserve requirements.

"So far as Government borrowings from the market and not from bonds may be used, it does not affect the situation. That sums up the direct influence. With relation to the indirect influence; the effect on the public growth or diminution of the debt, that is not susceptible of a positive statement because it is debated. In my own opinion, it has had very little influence of any kind."

Sale of Bonds In Open Market

To the question on "On the basis of the recent budget submitted by the President, to what extent will the Treasury have to sell bonds in the open market during the next fiscal year?", Mr. Devine remarked: "The President's estimate is too big and the new tax program is supposed to collect $460,000,000 and Baby Bonds will total approximately $1,000,000,000, with Social Security receiving another $1,000,000,000, so we will be able to retire $3,000,000,000 from the market.

Aside from that, I do not believe between now and December the Government will have to enter the market.

"This, of course, is also predicated on the Treasury receiving a good portion of the budget of $700,000,000 to be received from

Federal agencies. I do not believe the receipts will be as much as $700,000,000 to be collected by the agencies; hence, I think if it does not work out as the President's budget proposes, the Treasury will come in the market next December for $500,000,000."

Mr. Lanston stated: "Unfortunately, for the answer to the question, between nowand the end of the fiscal year 1941, we will have a Presidential election and the estimates of the present encumbent may not concern the new President, so I think if we get beyond November in our estimates, we really have to gauge the prospects of a change in the administration next November."

The Moderator then suggested: "Assuming that Mr. Roosevelt will consent to be renominated and is re-elected?" to which Mr. Lanston responded: "We may expect in the next fiscal year a deficit to be made by an increase in the public debt of $1,700,000,000. In order to meet this, the President has about $1,000,000,000 in trust funds from Social Security available to him in that fiscal year. Hence, he would require a total of $700,000,000 of proceeds from the sale of Baby Bonds. There is a prospect of raising the money from this source.

"There were large sales of Baby Bonds effected in December and January but this resulted from purchases by various pension funds under a loop-hole in the Treasury's wording of regulations. Such sales, however, have, since January, been stopped. In the fiscal year 1939, the sales of Baby Bonds were $691,000,000."

If such sales continue to increase, as they undoubtedly will, then I agree with Mr. Devine that not only will the said $1,700,000,000 of deficit be met in part by the $1,000,000,000 Social Security trust fund, but it would be more than met by sales of Baby Bonds. Then you are faced with the problem of retiring debt on quarterly periods, assuming again that everything works out right."

Mr. Currie suggested that Mr. Lanston "Had made a rather cryptic remark to the effect that the $700,000,000 agency repayments would not work out in the next fiscal year." This was clarified, however, when it was pointed out that the agencies would have from July to July to collect and both Mr. Devine and Mr. Lanston agreed that there would be a good chance for the agencies to obtain the $700,000,000.

$700,000,000 Agency Repayment Problem

Mr. Goldsmith then said: "Mr. Jones, at a secret meeting of the Senate Banking and Currency Committee, was reported to have said that $65,000,000 of the $700,000,000 was to come out of the Home Owners' Loan Corporation. Now on that particular agency repayment item of the budget, I gathered that if the H.O.L.C. continues to sell real estate at the same losses they have been incurring, they would have no capital left, so I am wondering whether that particular source will be available when the facts are disclosed in the Byrd Committee report concerning losses on real estate."

Mr. Currie questioned Mr. Goldsmith's information.

Mr. Lanston introduced another point: "It is not a criticism of the administration to state that every party before an election has certain political obstacles to overcome and it would be possible, in the case of agencies such as Federal Savings & Loan, F.D.I.C., and perhaps Commodity Credit, R.F.C., etc., to pull down the capital authorized through repayments, whether or not it means, as Mr. Devine says, that the agencies sell the bonds in the market. Hence, expenditures would be reduced under such circumstances, but that serves the purpose. Of course, after election you have eight months still remaining in the fiscal year. Circumstances may change so the capital may be plowed back again or the next President may add to his expenditures by rebuilding the capital of the agencies, so it really is a means of juggling figures."

Mr. Currie took exception to this and said: "I do not think it is quite as bad as you put it - that way of juggling figures, because a good deal of it will come, as I understand, from the F. C. A. You look through those various agencies in the Farm Credit and you will find they are greatly ~~grossly~~ overcapitalized. They are also holding millionsof Government securities.

"From yourpoint of view, the sale of these securities will be the same asthe sale of securities by the Federal Treasury. Hence, I think this question might be rewarded because some of the $700,000,000 receipts will be from sales of either guaranteed or ~~on~~ direct ~~sales of~~ Government securities by these agencies. ~~However, some of these agencies are grossly over-capitalized.~~"

On the question of Mr. Gifford concerning the probability of receipts from the budget of $700,000,000 from agency repayments, after considerable comment by the conferees, Mr. Devine said: "I stated there is a possibility then that the Treasury may get the amount during the next fiscal year. I was under the misapprehension that it would be necessary for them to secure it between now and June."

The Moderator then asked Mr. Gifford: "What are the prospects for reducing governmental expenditures and increased taxation? Is the debt limit likely to be raised during the next fiscal year?"

Mr. Gifford's prompt answer was "No."

To the question "What would be the effect upon money rates and bond prices of our being drawn into the war?", Mr. Eccles stated: "That depends on a number of factors. Naturally, interest rates is one of them. If we were drawn into the war, interest rates would go up. It does not necessarily need to happen, however. I think it would because I do not believe we would establish the type of taxes that we should. War has the effect, of course, of greatly increasing governmental expenditures. For every dollar of such expenditures made, some people think private capital would cease to be expended, but I do not think that would be true."

Financing A War

The Moderator then suggested: "We could finance the war with these excess reserves, couldn't we?"

To which Mr. Eccles responded: "You could finance the war without any further credit, in theory at least. We have far more money already in the form of deposits and currency than we ever had during the World War. Our deposits today in currency are almost double what they were at the time of the last World War. Therefore, so far as more bank credit is concerned with which to finance the war, in my opinion we would not need such credit if we would use that which exists. The war could be financed by the use of existing funds without an increase in interest rates if we put on enough taxes and if we took away the profits that accumulate as a result of war. I do not mean to convey that the authorities would do this, but I am just saying that it could be done."

The Moderator then asked: "Would you approve the use by the Treasury of long-term, non-market securities, similar in type, for example, to savings bonds -- which securities would be issued to savings banks, insurance companies and similar holders? Would you approve of the issuance of perpetual obligations of the type of British Consols?"

Mr. Morss answered this question: "I suppose if any savings bank took such offerings they would be putting themselves, so to speak, in hock to the Government. You say here they would be non-marketable. I think of the question from the savings bank point of view. I do not know whether or not it would be desirable from the Government point of view. I should think that any institution would want a considerable higher rate to put itself, so to speak, in hock and that the Government might be able to finance itself more cheaply by granting full market privileges.

"As to the maturity being perpetual, it is only psychological. A thirty or forty year bond comes close to being perpetual but the psychology is such that I think they would wait until the situation is a little bit less uncertain to test the psychology."

Mr. Emory agreed with Mr. Mores.

"Mr. O'Connor interposed: "Before you leave that question, I think it would be very interesting for some group to consider at some time the feasibility of a ~~non-maturity,~~ non-interest bearing security related to the required reserves of banks. The banks obtain no commissions in this country for the sale of government securities. We have a public policy which requires the maintenance of reserves. I would like to see the non-market proposition limited to the required reserves of banks so that the Government, in effect, would be saying that the interest rate would be determined on the highest Government rate of the year, but not on a subsidy basis. I believe this problem is going to arise seriously."

Possibilities of a "Run"

To the question "Is there danger in building up a large potential demand liability in the form of Baby Bonds? Under what circumstances do you think a 'run' might materialize?", Mr. Benson stated: "The holder can demand his money on these bonds, but I cannot conceive of there being a run on them country-wide where people generally would lose confidence in Government obligations and seek to cash in on the bonds. Should there be a boom in the stock market and the holder felt he could get more money by going into the stock market, [illegible], might apply as true to some of the holders, but not to a very large majority of them, in my opinion."

Mr. Devine stated in answer to this question: "I think the interest rate is so attractive that it would take quite a business boom and quite an increase in rates before there would be an attempt to sell a 2.90 per cent security."

Mr. Lanston interposed: "If you hold the savings bond for two or three years, the rate at which you can turn it in is much lower. For example, if you hold the security for three years, you would give up 3.25 per cent, not 2.90 per cent. If you hold the savings bond for seven and one half years and then turn it in, you give up 4.25 per cent for the remaining two and one half years."

Expansion of Commercial Loans
Improvement in General Business

"Commercial loans of member banks show a net increase of approximately $500,000,000 since early in the Spring of 1939 and have reached a total of $4,330,000,000. In the previous business expansion of 1936-1937, the total expansion from the lowest point to the highest point was approximately $1,700,000,000. Can we expect or should we make plans for an expansion during the year 1940 of as great an amount from the present level to the peak of total loans or equal to the total expansion seen in the previous period or greater? In short, is it likely that excess reserves may be materially drawn upon to meet the requirements of an expansion of business?"

In other words, are commercial banks likely to sell Government bonds to meet an expanding demand for commercial loans?

Mr. O'Connor answered: "As to the likelihood of it occurring, I have very grave d oubts. It depends, of course, to some extent on decisions abroad that we cannot influence by any policy of ours.

"If the Western front decides to risk the loss of a million lives, particularly England and France, or an attack from Germany takes more men out of production in factories and farms and mines, it makes more demand on the British Empire and more demand upon us, that would certainly influence our economy. It would constitute a decision which would be beyond our control.

"Looking at the question domestically and assuming no such happening abroad, I doubt if the expansion would be very great. Generally, I would say that most of the commentators about the prospect of an increase in demand for commercial loans ought to look at the Candian record.

"It is very interesting to me to see a banking system, or nearly as strict a banking system as I can think of, where the line for business production goes down, the line of commercial production goes up, and the lag is still 16 months to two years on the rise of commercial loans. Of course, if there was substantially increased production, there would be a consequent demand for commercial loans, and hence some increase in excess reserves.

"I do not see any selling of Government bonds entering into the picture. There is no prospect of re-discounts where there are excess reserves. I think banks learned how to be wary about turning to the Government bond market after the World War. Even in small institutions a comparatively large sum of money was lost. No, I think the banks, taking it by and large, would be scared to d eath to sell Governments in order to expand their commercial loans."

Colonel Ayres stated: "It seems to me quite improbable that commercial loans of member banks will increase by anything like $1,200,000,000 in 1940. It seems quite improbable that excess reserves will be materially drawn down to meet the requirements of business expansion this year."

Effect of Possible
Entrance Into War

The question was then asked: "If we actively participate in the war, what are the prospects that substantial commercial and governmental credits will be extended?" Also, what do you think Congress may do in this connection?"

Mr. Gifford promptly stated: "We are not going into the war. Every Congressman and every Senator has pledged his constituents that he will not send a boy to the European war."

Whereupon the Moderator suggested: "But let us assume, for example, that the Allies are apparently getting the worst of the situation over there, and assuming we do not go into the war, are we not likely to find a way to lend even in spite of the Johnson Act?"

To which Mr. Gifford said: "No, we are not. We are so frightened that we are having difficulty in lending Finland."

The Moderator then asked: "Will American manufacturers borrow to invest substantial amounts in additional plants or production of war materials for the United States or belligerents? To what extent do you foresee American industry in general entering the capital market for new financing?"

Mr. Parker answered: "I do not believe that the primary suppliers of war materials would borrow any money to build plants, but the business they throw to secondary people who may not be able to recognize the source of their orders may result in some additional lending to that type of borrowing.

"To the second part of the question, I do not see any hope, at the moment, of American industry in general entering the capital market for new financing during 1940."

Mr. O'Connor had no substantial difference of opinion with Mr. Parker.

Mr. Parker added: "American industry would enter the capital market substantially if there were certain changes in Government policy."

Will There Be Advance In Commodity Prices

Mr. Schwulst then asked: "Should we allow for an advance in commodity prices at least equal to the level tha t existed in 1936-1937? To what extent do you think we may expect an advance in commodity prices?"

Colonel Ayres did not believe there would "be an important advance in wholesale commodity prices this year."

Dr. Goldenweiser stated: "I think that prices of different commodities will go up very definitely. Agricultural prices are not likely to advance. Some industrial materials will go up and if you want to refer to the average, it is likely to go up slowly this year, but not anything like as high as it was in 1936 and 1937."

The Moderator then asked: "Can savings banks safely reduce the rates of dividend paid on deposits?...Can Insurance companies safely lower dividends to policyholders? Or Increase premium rates?"

Mr. Benson answered "No" to both questions, but he regretted that interest or dividend rates had to be reduced. He thought they could safely reduce dividends but did not think they should for any lower rates than those prevailing are an adequate return on capital."

Mr. Ihlefeld agreed with Mr. Benson. So did Mr. Morss and Mr. Emory. Mr. Morss thought such reduction in dividends should be avoided until it is impossible to continue the higher rate. Also, "on the premise that we have so much more competition now than we used to have."

How Low Can Bond Yields Go?

The Moderator then presented the next question: "How low can bond yields go before Government bonds simply cease to be an attractive investment to commercial banks, savings banks and insurance companies, with due regard to the maturities which are acceptable to those types of investors?"

Reference was made during the discussion of this question to the chart referred to herein entitled "Markets for Government Bonds."

Mr. Ball answered: "I can only speak from my experience, representing a bank of about $80,000,000 in deposits. So far as we are concerned, the situation has reached that point now for several reasons: The first is that we have not learned enough to see through the gold problem. There are many other monetary problems we do not feel we are acquainted with. There are conditions abroad we are very much disturbed about and therefore we have been making every effort to increase our earnings from other quarters outside of the investment market, so it is possible for us to take a position in the Government bond market of maturities of not more than five years.

"Today, we have $23,000,000 in Governments, most of them maturing within five years. We have over $27,000,000 in cash and about $30,000,000 in loans. So long as we can earn our dividends, or first write off these loans that Mr. Eccles' examiners force us to write off, earn a reasonable amount for dividends, we do not care about the rest of our earnings and we will maintain as short a term as possible.

Mr. Holton declared it as his opinion that: "Government bonds are always going to be a very attractive investment for us to buy but I do believe that if present rates continue, we are going to buy short maturities, as Mr. Ball has said. It seems to me, eventually, there is very little difference if Government bond levels remain as they are today or we are forced to reduce our dividend."

Mr. Ihlefeld contributed: "I should say that Government securities will never cease to be attractive. I think the United States Treasury has in its power to get all the financing which the Government needs. It can just about dictate the rate it will pay for that financing. In an extreme time I think the Treasury could offer alternatives for financing means that would make Government bonds comparatively more attractive, irrespective of yield, due to the inflationary powers they could use should we run into any kind of buyers' strike."

On 25 Year Maturities

The Moderator asked: "Can trustees justify the purchase of 25 year Government bonds to yield less than $2\frac{1}{2}$ per cent to maturity?"

Mr. Ihlefeld answered: "At the present time, no, but trustees can justify an investment in the light of existing circumstances."

Mr. Benson answered: "No. It would be very unwise for trustees to go in for 25 year maturities at less than $2\frac{1}{2}$ per cent,"but Mr. Morss' answer was a bit varied, "We have a trustee law in Massachusetts that permits the purchase of such bonds. The pressure of beneficiaries for income, plus the law justifying trustees in making the purchase, would combine to assure purchasing such a bond. When it comes to savings banks, the reason is very practical. It depends on our own earnings. We would, of course, resist as long as we could, but eventually we would buy unless, of course, the relatively other investments were better."

Mr. Emory thought the answer to the question depended on the relation of the yield on such Government securities to other investments.

The consensus of opinion was that if money investments were to all go down together, a 25 year maturity may be sold at less than $2\frac{1}{2}$ per cent.

Mr. Parker "felt they would both go down together, with the immediate short term bonds up to five years probably losing half as much as the long term bonds."

Dr. Goldenweiser agreed with Mr. Parker, but slightly differed with the second part of his answer and said: "I am inclined to think that the selling wave would probably affect long term bonds first as it has on the past two occasions of selling waves. I think, however, that the question has a pretty far-fetched hypothesis. In the first place, Mr. Gifford said we are not going to enter the war; and in the second place, it is not necessary that if we do, there is going to be a selling wave, so there are two improbable 'ifs'. Beyond that, your answers must become quite hypothetical."

Short and Long Bonds

The question was asked: "In the event of business expansion, would the banks sell their short Government securities and would this be a tip-ff to holders of long bonds that the prices of such bonds might likewise shortly be depressed?"

Mr. Devine thought: "The inclination is to sell long bonds first.

I am inclined to feel that people would more quickly get out of long term bonds. They are watching these bonds a little closer today since they are near their high prices. It was an unusual circumstance that the short term Governments started their decline somewhere around last October and the long terms did not decline until February of this year, but if we have an expansion of commercial loans, accompanied by increased reserve requirements, it would be good judgment to sell long bonds first."

What Can Change Budget Picture?

The Moderator then asked: "Let us assume that a conservative is nominated for President by both parties at the forthcoming conventions and that the level of interest rates is not at that time materially changed from what it is today?" The first question under that assumption is 'Would chances favor a decreased supply of Governments and a better outlook for a balanced budget?"

Mr. Lanston answered: "I do not think that anyone becoming President, regardless of who he is, whether it is Mr. Roosevelt, or someone else, is going to bring about any immediate change in the budget picture. In the first place, it is a tremendous job to understand. It takes time. You cannot uproot the social and economic philosophies which the Government has applied for eight years, merely by an election."

Again assuming a conservative is nominated by both parties, the Moderator asked: "Would institutional investors be thinking along the lines of further building up or of decreasing their total Government holdings?"

Mr. Benson stated: "I believe institutional investors will hesitate to decrease their holdings until other and perhaps more profitable investments are available."

Mr. Morss thought: "From a practical light, I do not think that savings banks in Massachusetts would change their policies very much based on an election. They do what they must do in order to pay the dividend."

Effect of Big Business Expansion

Under the same assumption, the Moderator asked: "Would possible big business expansion, development of loans, and consequent inflationary effects tend toward the taking of profits in Governments and reduction in total holdings?" And asked the conferees to also consider in connection with that question - "Or would little material change occur, assuming interest rates like those now prevailing, would actual buying or selling depend on whether bonds were available at rates which yielded a profit over the cost of the money?"

Mr. Ihlefeld stated: "I think Mr. Morss indicated that the problem should be looked at from the standpoint of the individual banks in the light of their earning requirements. If such institutions found there were better opportunities in other fields of investment and good bonds were available with desirable maturities, the institutions would probably shift from Governments to other investments. This would not be done for the sake of taking profits, but in order to increase their income return. However, the attitude of the individual bank would depend on its own courage or judgment, as the case may be, in taking profits against a future reemployment of their funds on a basis of the return which, together with the profits, would work out well for them."

Mr. Holton remarked: "I think the answer to the question would depend considerably on what caused the business expansion. If such expansion came from increased business from belligerents, I would not say there would be much effect. However, if the expansion came from a real peace that would develop honest-to-God business expansion throughout the country, I believe it would have a different effect.

Again assuming that a conservative is nominated and elected, the Moderator asked: "Would the feeling be that Baby Bond sales and proceeds from trust funds (Social Security) would provide the needed cash from then on?"

The Moderator interposed that the question would naturally concern the Government budgetary requirements.

Mr. Morss thought: "There would be an increased feeling that 'new cash offerings would be minimized by the Treasury.' Therefore, there would be more confidence in securities held."

Mr. Schwulst asked Mr. Gifford: "How soon, in his opinion, the budget would be balanced?" He answered: "That depends wholly on the election. I would like to remark that a conservative Democrat told me last night 'that if a conservative were elected, the trains would be very full out of Washington.'"

Restoring of Confidence

The question was posed: "If institutions such as savings banks and insurance companies by some means have their confidence restored, what mediums of investment are open to them through which they can more actively employ their funds at rates that will make it a good business operation?"

Mr. Emory answered: "As far as life insurance companies are concerned, I think that the effect would be largely in the rate of return they would obtain on the new investments. There might be some increased activity toward buying industrial bonds and perhaps the underlying obligations of reorganized railroads. Aside from that, however, I think it would be merely a prospect of a better return on funds available for investment."

The Moderator asked: "Would chances of decreased spending and reduced purchasing power in the hands of the consumer be offset by increased business confidence and restoration of purchasing power through reemployment?"

Mr. Eccles answered: "Certainly. At the present time it would have the opposite effect. That which creates employment is 'orders for goods' and assuredly Government expenditures, whether on the basis of a balanced budget or otherwise, does provide purchasing power. We have found that foreigners buying goods in this country with gold, provide pur-

"chasing power. Furthermore, any type of Government expenditures; for example, public works, would provide purchasing power."

Will Decreased Federal
Spending Bring Confidence?

At that point the Moderator further explained the question by stating: "Governor Eccles made it plain that the Government's power of spending has created purchasing power in the hands of a large section of consumers. If the Government stops spending and that source of purchasing power is decreased, do you think it would be offset by business confidence being restored and thus business employing more people, resulting in the distribution of purchasing power in such manner?"

Mr. Benson remarked: "I do not think increased business confidence will come through decreased spending. It is more likely to come through a general feeling that the Government will not interfere with private business and initiative as much as it has in the recent past and that this private business and initiative will be encouraged; that taxes will be reduced; that the investment of capital will be encouraged. Hence, through private investment and renewed business confidence, in my opinion, there will be reemployment through a resulting increase in business activity. This procedure has built America, over a century and a half, to the greatest country in the world."

Mr. O'Connor had this to say: "If 'decreased spending' in the question means Government decreased spending, I am on exactly the opposite side to Governor Eccles. I agree with Mr. Benson that we must put private resources and energies to work. They are so much greater than anything the Government commands by the orderly process of borrowing or taxing, that Government spending is insignificant by comparison."

Mr. Ball thought "that private protection would reemploy workers to more than take up any loss of purchasing power distributed through Government spending."

The Moderator then asked Governor Eccles: "Would the election of a conservative give impetus to granting the Federal Reserve System power to put on brakes more effectively than it has the power at the present time?"

After an effort to define a "conservative" in which the Moderator used Secretary Hull as an example, Mr. Eccles thought "that the Government in power has not very much to do with such a situation. As a matter of fact, the present administration was favorable to getting power to increase reserve requirements in whatever a mount was necessary in order to extinguish them. However, it was the bankers themselves, the conservatives, that prevented the Reserve System from having the power that was needed.

"So, if bankers are considered 'conservative' (and we judge by the past) and should we get a 'conservative administrator', I would say there was no chance, based on that past experience with the Reserve System, of getting power to increase reserve requirements. If a 'liberal' is in office after the next election, also based on past experience, I think there would be a very good chance to get the power."

Should Practice Be Stopped of Padding Subscriptions?

The Moderator then asked several technical questions dealing with the marketability of Government bonds. Under the first question, he asked: "Is it desirable to stop the practice of padding subscriptions? What steps could be taken to stop the padding of such subscriptions?"

Mr. Gilmartin answered: "I cannot see any purpose to be served by the padding of subscriptions other than the fact that perhaps it affords good publicity at certain times. I think the practice should be discontinued. The important factor, however, is the second part of the question -- 'how to discontinue it?'

"I do not think I have any solution, but would offer a few suggestions for further study. In the first place, I think the method in which the banks and insurance companies are permitted to subscribe could be changed so that instead of being allowed to subscribe to either the amount of their cash on deposit or a proportion of their cash on deposit, or a percentage of their capital and surplus, some other unit consistent with a particular issue of Government bonds might be used as a measure.

"Further, instead of a 10 per cent deposit being required on the part of others than banks, I believe that the percentage of such deposit could be raised. Perhaps, arrangements could be made for the immediate delivery of bonds against cash and thus avoid the 15 day lapse period between announcement and delivery.

"I think legitimate dealers engaged in business, not alone those considered on the list of recognized dealers , might be given an allotment instead of a subscription, based upon factors such as their capital, their distributing ability, and their volume of transactions. Also, some form of penalty may be established which would deprive them of the privilege of allotment for, let us say, a period of a year, if they engaged in the practice of trading in allotments or trading in rights. This, in my opinion, would discourage such practice and thus eliminate as many as possible of the power and simple free rides."

Mr. Devine remarked: "I do not think the privilege is used by banks as much as by individual security firms. I believe the Federal Reserve has made some progress in curtailing subscriptions. I understand there is in process an idea that henceforth banks will agree not to sell their subscriptions until the subscription books are closed. Such a procedure would help. Moreover, the dealers have agreed that they would not trade in new securities until subscription books are closed. However, the biggest factor under this question is the problem of scrutinizing individual corporations and security houses that paid their subscriptions. I do not believe that the situation is abused by the banks at all."

Mr. Lanston stated: "I do not think there is any excuse for over-subscription. It is true that it makes it successful. This racket can be stamped out by the Federal Reserve and the Treasury."

The Moderator then asked: "How large can the Federal debt safely grow?" It is said that we might go considerably farther than we have up to this time in discounting the future growth of the country and therefore the ability of the country to "grow up to" a Government debt structure expanded far beyond its present proportions. Do you subscribe to the economic soundness of this statement?"

Mr. Eccles stated: "It depends, it seems to me, on the extent to which the debt is taken by private and institutional investors and commercial banks. The only danger is an expansion of credit, whether it be public or private , is the inflationary effect of it. Further, one can be inflationary to the extent that they are brought about by an increase in the means of payment in the hands of those people or corporations who expend the funds.

"Government debt, to the extent that Government debt is purchased out of idle funds in the hands of individuals or corporations other than commercial banks, considering such bank funds as excess reserves, there results only a putting into circulation of what otherwise are idle funds and hence constitutes no burden upon economy.

"The burden of interest that we speak about, is not of itself a burden if the debt is held within our own economy, because the interest which is paid also goes back to the economy as a whole, increases income, and therefore increases our ability to meet taxes. A very different situation is created if the debt is held outside of the country."

How High Can Our Government Debt Go?

The Moderator then posed: "Did I understand you correctly, Governor, to say that it made no difference how high the Government debt goes if the debt was held within the country?" Can it go far beyond what it is now?"

To which Mr. Eccles replied: "Oh, yes, far beyond that. I am not saying that it is desirable for the reason that Government debt often does not result in the same character of increase in wealth that possibly private debt may result in. No Government would choose the Government debt procedure but it is a question of alternatives.

"A Government increases debts or deficits due to an economic or social condition that it is confronted with. Thus it becomes a question of alternatives as to whether or not the state of the economy is such as to be able to increase taxes adequately to get idle funds into circulation. If we are in a depression it is desirable to increase the debt as was done in 1932 and 1933 in order to increase the means of necessary payments.

"Now, with reference to the size to which the debt can go, of course the burden of debt, if there is any burden, is measured by the interest payments. It is interesting to note that the total interest payments on the Government debt today is approximately what it was following the World war when certainly the wealth of the economy as a whole was not equally so great as it is today.

"Take the history of England -- a very good example to observe with reference to public debt. The net debt of England has been increasing, except for certain periods, for a period of 300 years. Certainly the standard of living of the people of England up to the time of war was higher than it had ever been in its history so that Government debt has not destroyed England.

"The public debt of Great Britain is about two and one-half times per capita of what it is in this country. Certainly, we ought to be able to stand as much per capita as the British. Surely, our per capita wealth is greater than theirs. By comparison, our debt could reach one hundred billions of dollars, if it had the same relationship as the British debt has to its economy.

"It is a question of choice - whether you are going to borrow the funds to put them back into the income stream, or whether you are going to tax them. Britain has chosen to have a greater tax than we have, - at least on the middle income groups and on corporations. Therefore, it is a question it seems to me, of whether we choose to borrow the money to meet the problem of unemployment - the fundamental problem - or whether we choose to tax the funds and put them back into the income stream or tax them in a way that would make the owners put them back into the income stream.

On Borrowing From Commercial Banks

"Of course, it is a very different matter when we borrow from the commercial banks. What I was going to say in that connection, it is unfortunate that we have excess reserves to their present extent. It is my view certainly that at the time of the Banking Acts of 1935, 1936 and 1937, the central banking authority with the cooperation of the Treasury should get close enough to the money market so as to exercise a control over what we may term possible inflationary tendencies, and it was for that reason I undertook to get power to increase the reserves so that we could as a result get close enough at all times to the money market to avoid the huge excess reserves and thus tending to get Government financing out into the hands of the savers rather than into the banks. Today, I would be very happy if it were possible to prevent further commercial bank investments in Government bonds, for the reason that we already have a very large excess of deposits and currency beyond our need."

The Moderator interposed: "You have a very large excess of undigested public debt."

To which Mr. Eccles responded: "Well, the debt has been digested so far as the banks are concerned, but they have resulted in the creation of deposits. The situation is, those deposits are now held by corporations and individuals and they are on deposit in the banks. Our problem today is what we term the velocity of those funds. If we could get the deposits back into the income stream directly to the owners, if there are deterrents that some of the people talk about and they were removed and thus we could be assured of private investment to the extent of putting these funds back into the income stream, then, for God's sake, that is what we ought to do.

"But to the extent that they do not go back into the income stream, then they must get moving there through borrowing, especially if the national income is down. If this income goes up, then deposits should go back through borrowing; but we should not increase the total contribution to buying power so long as we have a lot of unemployed people."

Problem of Consumer Purchasing Power

At this point the Moderator stated: "It seems to me that the Government is, - through the selling of its bonds to commercial banks and the creation of deposits, - adding something at least to our purchasing power in one stage of the process. As soon as such government deposits are converted, so as to be paid out to people on relief or people on public works or on the public payroll in one form or another, it seems the circulation of the purchasing power stops; they go no further. We have but one process in turn-over of purchasing power and then it quits. That is evidenced by the velocity with which these commercial bank deposits circulate."

Mr. O'Connor then took up the discussion and stated: "The question of how far the Federal debt can safely grow is a matter of degree. Governor Eccles' measurement of the degree is different from mine. I think it is a question of how far you depart from the capitalistic system toward the totalitarian system, because the Government debt will go for some purpose or other. The kind of use to which it is put is extremely important. I do not think the Government is ready to accept any philosophy of perpetual debt. Furthermore, I do not find anything in British or French experience as to how much debt we can stand because their political system is entirely different from ours. They are responsible to their electorate; under our system a particular administration is responsible to our electorate.

"I again believe the Governor went a long distance in my direction when he talked about removal of deterrents to private investments and private spending. From my own point of view, such measurements as we have made in recent years on consumer purchasing power draw their fundamental basis from a Marxian thought which I do not accept.

"A Government creates a situation which then justifies the creation of debt. I mean in so far as the Government does create a situation. We have some evidence of the Government having created a situation of decreased confidence as far as individuals and capital are concerned through tax policy, through regulatory policy, through monetary policy and through credit policy.

"I think if Governor Eccles were clear from the point of view of a credit policy, so that we could get a proper relation of fiscal policy to credit policy, we might look at this question a little bit differently. Under existing circumstances, however, where control of credit policies is so practically helpless, I say the Federal debt cannot grow much larger, because of the psychological attitude that would develop throughout this country with amazing rapidity. Hence, those policies which justify support, encourage and increase the Federal debt, are extremely important. I think we can stand a somewhat higher amount of debt; how much higher is a matter that is very difficult to state."

The next question asked was: "Will commercial banks soon find themselves in a position where they will refuse to expand their deposits further, as will be necessary through the continued purchase of new Government bond issues? That is to say, they will not buy new bonds and expand their deposits if by so doing they are likely to impair seriously their capital - deposits ratio. Will the commercial banks be willing to accept new capital funds from the Reconstruction Finance Corporation in order to be able to continue to buy Government bonds without distorting their capital - deposits ratio provided those capital funds are offered on such a low interest basis that the investment of those funds by the banks in Government bonds could be done profitably?"

The Moderator stated: "I have just recently seen a compilation of the capital-deposits ratio of the largest banks in New York City. The National City Bank, for example, is down to about 6 per cent; the First National I think has 20 per cent; the Guaranty Trust Company is down to 14 per cent, and the Irving Trust Company is down to 13 per cent or 14 per cent. We have a number of them around seven per cent or eight per cent.

Study of Operating Ratios

The reader will bear in mind a study of the operating ratios of member banks in the second Federal Reserve district recently made public. The supervisory authorities recognized in the report that some modification of the old "rule of Thumb" ratio of bank capital to deposits of one to ten was necessary in these times of record-breaking excess reserves and low bank earnings. The new ratios can be regarded as giving a substitute formula for the traditional one to ten proportion of capital to deposits, which the supervisory authorities have used from time immemorial in judging the adequacy of the protection given depositors' funds by stockholders' contribution to the capital accounts of banks.

President Harrison of the New York Federal Reserve Bank pointed out that the ratio for all member banks in his district averaged 18.5% in 1939 or a ratio of $1.00 of capital to every $5.40 of risk assets. In terms of the old one-to-ten ratio, this percentage of deposits to risk assets represented a capital ratio of one to seven in Manhattan and one to eight and a half in other parts of the s tate. On this basis the present capital protection for that portion of deposits subject to investment risk is greater than during the two decades ended 1934, when the old one-to-ten standard was not brought into question.

The matter of Capital Ratios

The attitude of the supervisory authorities toward this matter of capital ratios is of more than academic interest to the banks. In New York State the banking law says that in any case where the combined capital stock, surplus fund and undivided profits of a bank or trust company do not equal ten per cent of its net deposit liability, the Banking Board may in its discretion require such a bank or trust company at the close of each accounting period, to build up its surplus until the capital account does give the 10 per cent coverage.

But it is understood that the State Banking Department has taken cognizance of the great expansion of cash items in the banks in recent years and is prepared, where a bank is sound and well managed, to deduct cash assets from total deposits in determining the bank's capital position. In some cases, it is said, the department may be prepared also to exclude Government securities maturing in two years from the assets subject to investment risk in determining the capital position of a bank.

Mr. Schwulst continued: "The point is this, are commercial banks beginning to get a little bit jittery with respect to expanding their deposits further through increasing their Government portfolios because their deposits are getting beyond where their capital funds can support them? Do you think the banks would be interested if the Government would say, 'We will see that the R.F.C. supplies you with additions to your capital; if you can increase your capital and sales of stock in the open market, the R.F.C. will buy preferred stock from you and perhaps charge you one per cent or ½ of one per cent on it, so you can use that money for Government bonds to meet fiscal requirements'?"

Mr. Ball answered: "I do not think the banks will worry about that, because I have not found anyone yet who can justify fifteen-to-one or ten-to-one or five-to-one. It seems to me it has to be analyzed with respect to what ratio should be applied. So, personally, I do not worry about the capital - deposit ratio. I think the banks are very much concerned about their expansion of deposits. I do not know of any banks that are reaching out to get them, even though there are some banks which take pride in how much their deposits have expanded this year over last year. I think that is the poorest yardstick a bank can apply. The banks should apply the yardstick of how much they are earning year in and year out, rather than an increase in deposit liabilities.

"We observed this problem when our time-deposits became very large.

About four or five years ago, 60 per cent of our deposits were time-deposits. In the meantime, our total deposits increased $25,000,000. We reduced our time-deposits by decreasing interest rates. Even though other commercial banks stood at their previous level, we reduced our rate to $1\frac{1}{2}$ per cent. One of our officers came into my office a fortnight after we had made the reduction and he said: 'This plan is a failure. We have only lost $250,000' and that is all we did lose but we tremendously benefited our earnings.

"I think the depositor appreciates the reason for low interest rates. We say, 'you can withdraw your deposit; it is guaranteed up to $5,000 with the F. D. I. C.; we are only trying to keep ourselves on a profitable basis', and that is good banking. I think it is very unsound to reach out for increased deposits."

The Moderator then asked Dr. Stonier to comment on the subject of the growth of bank deposits with respect to their capital fund. He said: "The banks are reminded of it, of course, by authorities now and again; but the question of the capital-deposits ratio between the two is a very debatable matter and I think it is pretty difficult to define simply a ten-to-one ratio any better than you could a nine-to-one or an evelen-to-one ratio. I think the banks generally would like to see investors come back into the market and buy Government bonds, but the people would rather put their money in the bank and only take one per cent as they are doing in New Jersey, rather than take a chance on the Government market."

The Moderator then called on Dr. Goldenweiser to comment as to whether he had observed any feeling of uneasiness on the parts of the banks in the country with relation to the capital-deposits ratio in the purchase of Government securities. He answered: "It strikes me as being a highly unrealistic attitude because it is a question of the character of the assets in relation to the deposits. So long as the assets are of a liquid character, then the banks know that they can sell the securities or borrow upon them at par. I do not think that banks need to concern themselves about the capital-deposits ratio. It seems to me that the banks do not concern themselves about it very much except where ill-advised examiners call it to their attention."

Is Government Bond Market Vulnerable?

The Moderator then asked: "At present levels, is not the Government bond market exceptionally vulnerable and is there not a general feeling among holders that such a condition of vulnerability exists?"

Mr. Devine answered: "I do not think we could say it is vulnerable if it is to the extent of two or three points market difference; but if it goes beyond that point, I would say it is vulnerable."

Mr. Morss replied: "The market is vulnerable in that it might go down and it is vulnerable in that it might go up. It may indicate that it might go either way, but of course with uncertain times, election year and war and so on, the market is vulnerable; and I think the holders of Governments are well aware of that. I do not think it is vulnerable in so far as we can see into the future with respect to a change in trend particularly."

Mr. Emory agreed but said: "Looking only at the domestic economic forces, I think it might be very vulnerable on the down side with war developments."

What if Commercials Cannot Absorb More "Governments"?

The Moderator then asked the next question: "What resources would be open to the Treasury if the commercial banks of the country should in general feel that they can absorb safely no more Government securities? Would the Treasury have to resort then to the direct sale of its bonds to the Federal Reserve System? If so, what would be the effect upon Government bond prices and interest rates?"

Governor Eccles replied: "I do not think that in the present situation the market is going to have an opportunity to take Government bonds so that whether or not the banks decide they do not want any is going to make very little difference. I do not think the question is going to arise as a practical matter. As long as we have the present Social Security system, which is accumulating $1,000,000,000 a year for investment, and the Baby Bond system, which does provide an opportunity for investment of funds of individuals at a high rate in Government securities, there will be such a demand for Government securities on the part of institutional investors that whether the commercial banks take any or not I do not believe is going to make any appreciable difference in the situation."

The conferees generally concurred in the answer.

Necessity of Buying New Issues to Support Market

The question was then asked: "Is it true that the market for Government bonds is really a liquid market or is it true that with respect to long Government bonds in particular the large institutional holders really have a frozen asset - an asset of which no great number of them could divest themselves at any one time? In short, are not the institutional holders in the position of having to take, willy-nilly, whatever amount of new Government bonds may be offered to them out of the fear that their refusal to do so would bring about such a break in the Government bond market as to cause very heavy losses through Government bond depreciation? In short, they must buy new issues to support the market for the ones they already hold."

Some of the conferees were inclined to believe from their experience of last September that Governments were not thoroughly liquid, but Mr. Devine disagreed and said: "You could not sell any other securities either and you have a better market for Government bonds than you have for any other security. As a matter of fact, you could not sell municipal bonds at all at any price. If it took two hours to sell a Government, you couldn't sell a municipal in less than a week."

The Moderator a sked Mr. Morss: "Do you really feel any sense of uneasiness about the liquidity of your Government portfolio?"

He answered: "In reference to my comment on the uncertainty of the times, that does not necessarily mean that we only visualize a down trend. So long as our deposits hold up, as they likely will, there should be a market for Government bonds."

"Bears By The Tails"

Dr. Goldenweiser summed up this question: "It seems to me that the banks have a bear by the tail only in the same sense that they have a bear by the tail in having assets at all. If the banks try to sell all their assets, it would break all the markets. I think this particular question is directed at a very widely spread misconception on the part of the banks, and I think for that reason it is a good question. But, so far as making any sense is concerned, it does not make any."

Mr. Lanston remarked: "Can you not put this idea of someone having a bear by the tail a little bit differently? If you have to make that assumption, it looks to me as though you have two bears holding two tails. The banks are holding the tail of the Government markets and the F. D. I. C. is holding the tail of the banks."

Mr. Eccles stated: "Is it not a question of alternatives? The banks take government bonds because it is the only alternative they have. They do not do it because of patronism. They take bonds, as has been indicated here, because of the lack of any other opportunity to put their funds out on a profitable basis so that they can make the earnings they think they should mak e. They will always continue to do that in the future as they have done it in the past. So it seems to me that all we may say with reference to this subject is not going to change the policy of the bank over any longer period of time if it has no other recourse.

"I would like to make a brief statement with relation to the question that has been put before us about inability to sell the government bonds. Mr. Devine made a reply there which by comparison with anything else is an excellent one. One of the reasons for changing the bank examination procedure is that when a bank has a mortgage loan that is not in default or it has any other loan that looks satisfactory on the face of it, no one measures the value of that loan by its immediate liquidity. And yet, because there happens to be a quotation on the market for a certain small amount of municipal bonds or any other securities, then they want to measure the entire value of the portfolios of all the banks on that basis without considering the intrinsic value of the security. Now it just does not make sense."

Value of Going Concern and That of Receiver

The Moderator interposed: "In other words, you think there is one value to an institution as a going concern and another value perhaps as a receiver in charge of its assets?"

Mr. Eccles replied: "Yes. But even a receiver is not necessarily compelled to liquidate tomorrow. Many a receiver liquidated at one hundred cents on the dollar; whereas, if they liquidated on the date they closed, "they would have done so at less than that amount. A liquidator does not have any idea of pegging a government bond market or think that the government bond market should be pegged.

"There are two approaches, it seems to me, to the government bond market, - one is from a monetary standpoint; that is, to buy and sell government bonds for the purpose of affecting the excess reserves, - the money situation. Certainly under present conditions, no action on the part of central banking authorities would have that in mind for the purpose of either buying or selling government bonds today. It could not be done for the purpose of influencing the interest rates. The banks could not be forced to borrow from the Federal Reserve.

"In the second place, there is such a thing as meeting a panic condition which has no monetary reason. To the extent that we are different from any other country with fifteen thousand banks instead of a few banks, it is very much easier to create a panic psychology than would otherwise be the case.

"It seems to me that it is important for public authorities to do what they can to help stabilize a government bond market. I do not mean that they should over the long range trend try to stop interest rates from going up or going down, so long as there is the large excess reserves in the bank, but assuredly they can moderate the trends so that they are not the excessive type which would tend to create panic in the markets."

Federal Loan Policy

The Moderator again interposed: "Governor, I understand you now to be talking about buying and selling governments, - that the Federal Reserve would not through its purchase and sale policy attempt necessarily to hold the bond market up to a level, which, in the light of general market conditions, might be considered to be artificial. Now, if I understand you correctly with respect to the Federal Reserve System's policy of lending on "governments, you indicated - leaving the question of soundness out of it - that the Federal's policy would be to lend on those bonds...that you could not conceive of a situation economically where the Federal would refuse to lend par on such securities?"

To this Mr. Eccles replied: "No, I cannot, because the situation would be controlled by interest rates. If the government's power was to be used for monetary purposes in order to restrict the use of credit, it would not be refused. There has been no time when the Federal would not take eligible paper discounted at its face value, of course at a rate, and there is no reason why you should not take government bonds on a bills payable basis at par at a rate."

Mr. Lanston commented: "What I cannot understand is the basis for lending a t par on 2's of '47 and par on 2-3/4's of '51. It makes the banks price conscious."

To which Mr. Eccles responded: "In one area they might be getting 7% on the paper and in another they might be getting 1½%, and yet you do not change the amount that you loan on the paper discounted. We have the power to make advances on any kinds of assets that may be sound and the rate is the same to all borrowers. Of course, we have the right to ask additional collateral."

Restricting Excess Reserves
and Tightening Money Rates

Mr. Goldsmith asked Mr. Eccles whether he could conceive of any conditions in the business world where he would think it advisable for the Federal Reserve to use its powers to restrict the excess reserves and tighten money rates.

To which he answered: "I can conceive of a situation of that sort. A condition of reasonably full employment where merely a further increase in the expansion of bank credit would only bring about an inflation in prices 'and would in no way increase the production of wealth. Under such circumstances, there should then be a restricted money policy, a tightening of rates, and everything possible should be done to stop a further expansion of credit on the part of the banking system."

In response to another question, Governor Eccles could not now conceive of a rise in prices and a shortage in skilled labor or a boom psychology where a n expansion of credit on the part of the banking system would call upon the reserve facilities. He stated: "I could not conceive of using a monetary mecha nism to deal with a problem which is not monetary."

In the Event of War - What?

The Moderator then asked: "In the event we are brought into the war, to whom would the Treasury look for the absorption of the large amount of new bonds that would have to be issued? Would a system of forced savings to be used for the purchase of such Government bonds be a likely possibility in view of the present size of the Federal Government's debt?" And Mr. Schwulst added: "I read in the paper recently where the government was giving some consideration to the question of forced savings."

Mr. Eccles: "Only in case we had full employment. If so, then it seems to me that you would want to resort to a tax on consumption so that you could release savings for the purpose of prosecuting war to the extent that you still had a problem of the unemployed and the utilization of your facilities.

"Certainly you would not want to restrict consumer buying power. You would then either want to borrow for the purpose of financing or you would want to tax what would appear to be excessive savings. At present the British are talking about a reversal of their taxing power. They anticipate a condition of full employment. With this condition, they want to reduce the standard of living or consumption on the part of their people so that the energies of production from their people can be directed into the prosecution of war.

"An effective way to do that is to tax those people and reduce their standard of living; to direct what they earn into the investment of war production. I can well conceive, if we have a condition of full employment, where we may want to resort to exactly the same tactics.

"If you read Dr. Schacht's speech before he left Germany, you will find exactly the same type of policy that was advocated in Germany during all the period up to the time he left.

"There was no inflation in Germany for the very reason that here a totalitarian state prevented inflation because they forced idle money into circulation through taxation. Therefore, when Mr. O'Connor speaks with relation to taxing and doing other things, you create a totalitarian state, you have an example of a totalitarian state doing exactly the opposite... at least for a five-year period."

III. INTRINSIC VALUE OF GOVERNMENT BONDS

Moderator Schwulst then asked the last question in the agenda: "Are there fears in the minds of bond holders that the Government's fiscal policies are definitely out of hand and that only through forced inflation of commodity prices and wage levels can tax receipts be brought up to a point where the budget can be definitely balanced? Will not this bring with it a reduction in the purchasing power of the principal invested in the bonds and the interest collected thereon, with the consequent forcing of the prices of such bonds downward?"

Mr. Benson answered: "No, I do not think that the fiscal policies of the government are really definitely out of hand. I cannot say that they are that bad. I still hope that without a forced inflation of commodity prices, we can balance the budget. I think this has to be done. I do not yet see a trend in that direction; however, but I am still hopeful that conditions will improve before a boom that would get fiscal policies beyond the control of the government.

"I think it is true that increased taxation, if that is necessary, will bring about inflation and will reduce purchasing power of the principal invested in government bonds as well as all principal and interest. This would certainly tend to reduce standards of living in this country. All of those who work and produce have to bear the entire burden. That is why I think the theory of government expenditures taking the place of private investment is wrong. I do not believe that government spending takes the place of private spending in any way. Most government expenditures are for non-productive purposes, increase the burden of debt and reduce the standard of living. However, I do not believe we have gotten that far. But I do think it is time we saw a change in the opposite direction unless we do go too far."

Mr. Morss agreed with Mr. Benson and thought it was by no means a hopeless situation. He remarked: "Yet, there are fears that somehow by mischance we will work toward a crisis in which event there would be a reduction of bond principal. Certainly, we ought to bend every effort to avoid a crisis rather than to spend our time fearing it. I think that any trend in fiscal policies that is unsafe can be modified to the point of reversal. It is true I do not see any change in this trend as yet."

Mr. Emory agreed.

Public Estimate of Fiscal Policies

Dr. Stonier remarked: "I do not think that the fiscal policies of the government are such that the people have lost complete confidence in them. However, I do think that in the next six or eight months there will be a very great test on that point, as to whether or not the people in this country think that the fiscal policies have been able to restore employment and that the issue is going to be fought out very largely along fiscal lines.

"There are situations; such as, preparations for war, which, if the Allies are on the losing side for the next six months, will result in a great deal of thought being given toward further encouragement of debt for war preparation. Whether or not we might get into the war to help decide the issue, there is going to be considerable interest in this country in war money, - money being spent by government for war preparation and regardless of there being one political party or another in control, I think that such a situation will continue.

"However, I would say that there is greater lack of confidence now in present fiscal policies of the government than there was two years ago. Those who have been responsible for the fiscal policy of government today are more on the defensive than they were at that time."

On Budget Balancing

Mr. O'Connor offered: "I do not think that the government fiscal policies are completely out of hand. However, I think there is a distinctly disturbing trend. Such a view is widely held among conservative-minded and practical-minded people. I think the budget can be balanced without enforced inflation. I would say the President in effect asked us a few years ago to get used to the level of seven billion dollars budgetary expenditures...now we are asked to get used to a level of around nine billions.

"I think if the budget were somewhere around $6\frac{1}{2}$ billions of dollars, the tax system would be able to work without an unendurable burden. I do not think if it were much higher than that a tax system could be made to work. We ought to recognize that so far as a so-called World-War-Level of taxes is in relation to national income in this country, - federal, state and local, - it is practically twice as much in dollar amount in taxes now as the government received in the World War, and in relation to income, exactly twice as much. On a per capita basis, it is something like fifty percent more."

Mr. O'Connor continued: "The distance the Federal Government can go without encroachment on state and local resources, and therefore the more dependence of state and local governments on the Federal government for hand-outs without the loss of their local autonomy, is a very nice question.

"As far as our calculations go, we think the budget can be balanced with about six and one-half billion dollars expenditures. We also think that a modification of rates of taxation will probably produce more revenues. I believe Governor Eccles presents a hopeless picture, when he talks about financing, and secondly when he talks about high taxes to reduce consumption in the event of war. That is rather disturbing. I do not think that you can do this. Even a conservative government has to give assurance that increased taxes will mean a balanced budget. You recall that when Mr. Hoover ran into a deficit, the country accepted taxes, and there was a very substantial increase in the level of revenues, but it only resulted in more spending. We must see a reduction in Federal expenditures before the country is likely to accept a very high tax program to reach a balanced budget."

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