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(Copy with corrections was made for book.)

Statement by Mr. Eccles at Federal Advisory Council Meeting

February 20, 1951

While the Chairman is out, I would like to make a few observations. It has been sixteen years last November since I first met with the Federal Advisory Council. As I read this statement, I must say that I had to conclude it had reached a new low in ~~its~~ any constructive, realistic, courageous approach as an advisory ~~board~~ body to the Board, and it had reached that low at a time when the Board was possibly in greater need of courageous and realistic advice than they have ever been. This is no time for the lack of courage, and it is no time for intellectual bankruptcy. I think it was the American Bankers Association, at one other time,in my recollection at the bottom of the depression, when some of the leaders were demanding that the Federal Reserve, the Open Market Committee, the bankers boycott the purchase of Government securities as a means of forcing a balancing of the Federal budget. I do not know whether the Federal Advisory Council went along on that, but that was the position of some of the leading bankers at that time.

Now this dilemma that we have gotten into I think is somewhat due to the lack of courage and leadership in the American Bankers Association. The position taken at the Convention last fall tended to bring about the situation we are now confronted with. I think ~~that the~~ giving to the Secretary of the Treasury at that time ~~of~~ the feeling of independence of the System was one of the things that enabled him to make the statement that he made several weeks ago when he announced a pegging of the entire Government securities market, announced it without consultation with or approval of this Board or of the Federal Open Market Committee, without our knowledge or consent. That

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was equivalent to the taking-over of the functions of the ~~Reserve System~~ Open Mkt Com; it was equivalent to bringing about our complete abdication. There is a great difference between the present situation and the one we were confronted with in the depression. When we were not concerned about printing-press money, when we had ten million people unemployed, and forty percent of our plant capacity idle. Naturally there was cheap money because there were not any demands or business needs for it. When we went into the war period, the Reserve System had no power. It had no Government securities in its portfolio to speak of. It did not have enough to pay its expenses. It had no power to further increase reserve requirements. There was an effort, and the Federal Advisory Council then supported the Board in the effort, to get increased authority for the Board to double raise reserve requirements ~~by 50 percent~~. That was the action ~~of the~~ supported by the Advisory Council and the twelve Reserve Bank presidents in order to get closer enough to the market so the Open Market Committee could get some control. That was done without advising with the Secretary of the Treasury. It was thought ~~that~~ that was a responsibility of the ~~Council and the Board~~ Reserve System. The Council was not so concerned about the fluctuations of 1/32 or 1/4 of one percent at that time. We got into the war, and we got stuck with the pattern of rates that ~~had~~ existed at that time because you cannot raise from $2 to $5 billion a month in deficit financing on a falling securities market and rising interest rates. It ~~was an~~ would be an impossibility. Anybody that knows anything about market operations would know that. We have had since the war ended on balance a balanced budget ~~on balance~~. In one year it was unbalanced, but there has been a cash $13 billion surplus for the period. In that period of time this Board has

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consistently pointed out to the Congress the need of legislation or the need of facing-up to the problem. During the time we were asking for supplementary legislation that would be a partial substitute because of this public-debt problem, we got constant opposition from the Council and from the bankers to requests for that authority. At the present time we have a budget surplus, and, when we get into a budget deficit, we will again be frozen. I would be the last one to undertake to change the interest rate structure if we get into deficit financing. You have to rig the market for Government financing, and you have to support a pegged pattern of rates as a practical matter, in a period of that sort. There is an opportunity, and there has been one for some little time, to get a realistic rate situation. We have had no help whatever in that regard from either the bankers or the Federal Advisory Council. There has been this attempt at tight-rope walking, and the net result is the dilemma that we are now confronted with.

You do not solve problems by being unwilling to face them and meet them. There never has been a period when we could take action with reference to the rate structure with less danger of bringing about a deflation. That was not true in 1947, 1948, or 1949. It has been true since Korea that action to deny the market reserve funds at the will of the market could have been undertaken without any danger of a deflationary development, and it has been the only time when there was a real opportunity to get a realistic rate and to use, with some greater degree of freedom, the power of open market operations, which could not be used during the War with great deficit financing and which it was somewhat difficult to use in 1948 and 1949 because a deflationary situation could have been brought about, whereas that is not possible at the present time.

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The Federal Advisory Council says they do not believe that slight changes in short-term rates are effective, and they do not think, because of the structure of the public debt, that substantial changes in rates can be carried out. That being the case, they are indirectly advising a freeze, a pegging of ~~prices~~ present rates. If slight changes in rates are ineffective, then why make them, and, if any substantial changes cannot be made, then it leaves you ~~only~~ in the situation of freezing the market where it is and of having the Federal Reserve System abdicate in favor of the Treasury. That is what it means. It can mean nothing else. It seems to me that we are confronted with a serious situation, of course, but the sooner it is met, the better for the economy as a whole.

Now what are we doing that we should not do, and what should we do that we are not doing? We are buying freely and have been buying freely at pegged prices a very large amount of Government securities at a time when the fiscal policy is anti-inflationary and at a time when the gold moving out of the country is at such a rate that it is very anti-inflationary. Yet, in spite of these two very anti-inflationary forces, our operation has been of such a nature that it has furnished to the market $3-1/2 billion in reserves in seven months, and on those reserves the banking system has expanded credit at a most alarming rate, which has reflected itself in increased prices. The inflation we have had could not have gone forward without the easy money policy, without free access by the banks to Federal Reserve funds.

The banks are not the only ones that have been expanding credit, that have been letting securities run off to make bank-loan expansion. The

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non-banking investors have been sellers, and very heavy sellers, at an alarming rate. The reason is, the present rate is unrealistic in the situation that exists. The Socialist Government of England, which owns the Bank of England — which could buy the entire public debt and could finance without interest if it chose, just as we could — has raised their rate of interest on long-term paper just recently by 1/2 percent in order to induce the public to hold securities and to buy securities. And here we are following a policy that might well be suited to what one would expect the socialistic government to do. Canada has just done the same as England. The Governor of the Bank of Sweden resigned over this very issue because the central bank was supporting prices, below par mind you, but they were pegged. They put in a new governor, continued the policy, but finally succumbed and gave the market a realistic rate.

Now the sooner we face up to the situation and give the long-term market (insurance companies, banks, savings institutions) the type of long-term investment they will hold, the better. That in itself will not stop the sale of these long-term securities. The Treasury, if they followed our advice and policy, would make available to the market long-term securities on such a rate that they would have assurance from the insurance companies, the savings banks, the big institutions, that they would hold the securities. It may take a 3 percent long-term rate, maybe a consol, maybe a nonmarketable security. They have been complaining about this rate for a long time. And we are inducing them, inviting them, to sell the securities to us at a premium so that they can make other loans, buy other investments, at 2-3/4 percent.

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Now, why does not the Treasury consider some of the advice we have given them for months? It is not a question of raising new money. We have no new money to raise now. If you go on a program of pay-as-you-go taxes, you will not have to raise new money. The problem is to stop bank-credit growth. You can have a balanced budget and leave the credit doors open and still destroy the dollar and destroy the public credit with a pegged rate policy that is being encouraged with the indirect support of the Federal Advisory Council and the American Bankers Association. That is exactly what has happened. Now, why do we not go out and announce that the long-term refunding and financing is going to be on a 2-3/4 or 3 percent basis and let the long-term Government bonds outstanding today adjust to the new financing? Maybe there should be a conversion privilege. Then you would get the long-term investor to hold the security, which they certainly would do under those circumstances (if they do not, then it will be time to go to Congress and get additional power to control the creation of bank reserves).

When it comes to the short-term rate, I am the last one to think, knowing banking as I do, that a change of 1/2 percent will check bank-credit expansion. I doubt if 3/4 or one percent would do it. The banks do not have to sell their Governments; they can let bills and certificates run off.

It is going to be necessary to get supplementary powers to control this bank-credit expansion, which this Council and the bankers have vigorously opposed. I do not think it would be necessary to use those powers, but, if you do not get them, I can tell you just what is going to happen. You are going to get from the Economic Advisory Council, John D. Clark, Leon Keyserling, and, I think, some of the

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people in Charlie Wilson's office, support of this view: you are going to get a direct freeze of credit at the existing situation. That would be much more direct than the present type of control, and I should think you would much less rather have that. But you do not solve this problem by side-stepping or refusing to face it. The American Bankers Association, the Federal Advisory Council, should be far more interested in this problem than the Open Market Committee or the Federal Reserve Board, if you want to preserve the banking system as we know it. I am talking as a banker. You are not going into a situation that is for a temporary period. It is ~~the~~ a situation, from all that we can see, that has no terminal point. The way to deal with the situation is not only through a balanced budget, but through curbing bank-credit expansion when you already have more money, including bank deposits, than there are goods and services. That is the inflation. Adding more credit, which creates more money, only increases the inflationary pressures. You cannot increase the supply of goods and services fast enough to take care of the military and Government demands and at the same time take care of the civilian demands which are going to be supported by credit. You have to get the financial side of the problem matching the physical. You cannot take out of the economy the goods and services the Government needs unless you take out the financial effects, and at the same time avoid further inflation.

Now this idea that is expressed in this statement, that you have to finance the defense effort: you should finance not by adding to the money supply ~~from the civilian to t~~ but by transferring part of the money supply from the civilian to the military, just as you transfer the goods from the

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civilian to the military. You should not add to it. What has been going on is an addition to the total supply.

It seems to me that the Federal Advisory Council and the American Bankers Association would recognize that this problem we are discussing parallels the defense problem itself. It is not a problem of personalities. It is not a question of a conflict necessarily between the Reserve System and the Treasury because of a personality. This is a basic policy, a basic question in monetary and credit action that should be faced courageously and as absolutely supplemental to, and as hardly secondary to, the physical and the entire defense effort. And yet the Secretary of the Treasury thinks, and it is being treated today, as a conflict of personalities. It is being talked of as a matter that is one or 2 or 3 or 10 or 25/32s of a percent. What is called for today is a program that will control and curb bank-credit growth and expansion at a time of redundant supplies of credit when you have a terrific inflationary pressure. It is a program that calls for a realistic rate that will induce the long-term investor, particularly institutional investors, to buy and hold the long-term securities and not sell and create additional reserves. It is a program that will permit the short-term rate to go up as far as the long-term will permit. The long-term is a limit on the short: the short will not go up completely to the long.

Now you either take that or you take the possibility of the regimented arena of controls to be applied throughout the economy. It seems to me a statement like this one is not a statement that we have reason to expect from this Council at a time when we need leadership and courage and help.

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It is a statement, as one of our economists described, that is as ~~long~~ wide and as shallow as the Platte River. As I said, after sixteen years here, I have never seen a period when the Reserve System and this country were in greater need of help and courage than they were today, and I have never seen a time when the bankruptcy of this Federal Advisory Council or of the American Bankers Association was greater than today.

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